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CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS
FOR THE YEAR ENDED
JUNE 30, 2008

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**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS**

For the Year Ended June 30, 2008

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MEMORANDUM ON INTERNAL CONTROL

December 22, 2008

To the City Council of
the City of Richmond, California

In planning and performing our audit of the financial statements of the City of Richmond as of and for the year ended June 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we identified certain deficiencies in internal control that we consider to be material weaknesses that are included on the Schedule of Material Weaknesses, and other deficiencies that we consider to be significant deficiencies that are included on the Schedule of Significant Deficiencies. The status of prior year material weaknesses, significant deficiencies and reportable conditions has also been included in this report.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe to be of potential benefit to the City.

The City's written responses included in this report have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of City Council, management, others within the organization, and agencies and pass-through entities requiring compliance with generally accepted government auditing standards, and is not intended to be and should not be used by anyone other than these specified parties.

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CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF MATERIAL WEAKNESSES

2008-01 Budgetary Data Should be Accurate and Analyzed for Completeness

Budgetary controls are an extremely important part of the City's internal control structure. We were provided with a report of the original and final budget balances by department for use in preparing the budget actual statements in the financial statements. However, upon review of the report and further inquiry of Finance and Budget staff, we found that the report contained numerous errors, omissions and overstatements.

The errors we noted included the following:

- A. The General Fund's departmental expenditure budgets were overstated by \$41 million due to an entry error and the input of one department's budget amount three times. Although there were no actual expenditures against these erroneous line-items, the potential for expenditures in excess of approved budget amounts did exist.
- B. The General Fund's revenue budget was overstated by \$751 thousand due to an entry error.
- C. The Redevelopment Agency's expenditure budget amounts included in the report were completely wrong, and the revenue and transfer budgets were not included in the report at all. We had to re-input the budget amounts into the financial statements based on the approved Redevelopment Agency budget with the help of Redevelopment Agency staff.
- D. The Gas Tax Special Revenue Fund reported an approved intergovernmental revenue budget of \$4.7 million, but the actual intergovernmental revenue for the prior two fiscal years was only \$1.8 million each year, and City staff could not explain why the current revenue budget was more than twice the historical revenue levels.
- E. The General Purpose Special Revenue Fund's Other Taxes Revenue related to the North Richmond Waste and Recovery Mitigation program were not included in the original budget due to an "administrative oversight".
- F. Certain approved budget amounts were not included in the report provided for preparation of the financial statements including the 2005 Pension Obligation Bonds Debt Service Fund's and General Debt Service Fund's revenues, transfers in and debt service expenditures of \$7 million, \$6.8 million and \$3.5 million, respectively.
- G. Although not significant amounts, two entries totaling \$52 thousand that had to be posted to both the budget system and the general ledger system were posted to the budget system incorrectly. The entries were posted to the wrong fund in the budget system.
- H. The legal level of budgetary control is at the Fund level, therefore all budgets should be adopted at least at that level. However we noted that the Redevelopment Agency's budget is adopted in summary.

City staff spends a fair amount of time fine tuning the budget during the fiscal year. However, the actual results must be compared to those budget amounts. Any variances should be investigated and explained to ensure that errors do not exist. If this analysis had occurred at any time during fiscal year 2008, the \$41 million overstatement in the General Fund and most of the other errors noted would have been immediately discovered.

CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF MATERIAL WEAKNESSES

2008-01 Budgetary Data Should be Accurate and Analyzed for Completeness (Continued)

Expenditures are controlled at the fund level for all budgeted departments with in the City. This is the level at which expenditures may not legally exceed appropriations. When the approved budget is uploaded into the budget system, a complete reconciliation of the totals should be performed to ensure that errors do not exist. Without this reconciliation, overstated budgets could result in expenditures in excess of approved appropriations.

And, since most fund expenditures are based on the level of revenues expected to be received during the fiscal year, when revenue budgets are not analyzed to ensure they reflect reality, approved appropriations could be based on a revenue source that will not materialize. All revenue budgets should be scrutinized to ensure they reflect the estimate of actual revenue that will be received by each fund.

Finally, with the implementation of its new financial system in 2009, the City should ensure that the budget module is integrated with the general ledger module. The use of two separate systems should be discontinued. In the event this is not possible, the two systems should be reconciled on at least a monthly basis to ensure differences and errors do not exist.

Management's Response:

- A. The City's previous SAP software generated an erroneous entry that resulted in an overstatement of budget. This duplicate budget was not easily identifiable in the YTD Budget Report because the entries were posted at the highest roll-up level in the system rather than in a particular department and required the assistance of the IT department staff to generate transaction detail records to identify. With the implementation of the MUNIS software, the City does not anticipate such system generated errors with automatic posting occurring.
- B. This system generated budget error is interrelated with A above.
- C. Redevelopment Agency staff confirmed debt service and transfers in/out were not correctly captured in SAP due to inconsistent use of the SAP system to record the budget. In SAP, the budget was entered by cost center without adjusting the prior year balances. Excel spreadsheets were used for analysis, but these adjustments were not entered in SAP. The City implemented the MUNIS accounting system in December 2008, and account balances are closely monitored through monthly reporting.
- D. According to the Adopted Fiscal Year 2007-2008 Capital Improvement Plan Budget, the revenue budget for the Gas Tax fund was \$4.9 million. The revenue budget was significantly higher in fiscal year 2007-08 than in the prior fiscal years because it included a large fund balance while prior years reflected only the amounts budgeted for the current year.
- E. Because department staff expected the remaining budget to automatically carry forward to the next fiscal year, they did not include budget to cover planned expenditures at the beginning of fiscal year 2007-08. Department staff has been reminded to budget planned expenditures for the subsequent fiscal year that have not been encumbered with a purchase order.
- F. Due to changes in personnel assignments during the fiscal year, some of debt budget was inadvertently missed in posting to SAP. The City implemented the MUNIS accounting software which makes entering budget detail easily accomplished through a decentralized process. This allows Finance staff more time to review entries to ensure accuracy.

CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF MATERIAL WEAKNESSES

2008-01 Budgetary Data Should be Accurate and Analyzed for Completeness (Continued)

- G. The City has since implemented a new and improved financial system (MUNIS); also, the accounting and budget divisions are working more closely in an effort to alleviate these types of errors.
- H. Because of the number of funds managed by Redevelopment Agency staff, they have used a summary format to have their budgets adopted in the past. Staff has been asked to include a total by fund when submitting their budgets for adoption.

2008-02 Long Term Debt Transactions and Accounting

The City has more than 27 debt issues for which interest and principal transactions take place throughout the year. In addition, the City had new debt or leases issued during the fiscal year that needed to be recorded. During the interim phase of the audit we compared the principal and interest payments in the general ledger to the current maturity schedules provided by the City and we noted that there were several debt issues for which the amounts did not agree. While we understand that Finance and Redevelopment staff were waiting for assistance with the recording of entries for the 2007 Redevelopment Agency Bonds and 2007 Civic Center Bonds, all debt service transactions should be recorded when they occur. The debt service payments on each maturity schedule should be reconciled to the amounts in the general ledger on a monthly basis to ensure proper recording. In addition, performing this reconciliation on a monthly basis will help to make sure that the City's debt service payments are made on time and that the long term debt balances are accurate.

We provided the listing of the debt service payments that did not agree to the maturity schedules to Finance staff for resolution prior to the year end audit. However, the corrections and reconciliations were not completed until the year-end audit started. As a result, we proposed fifteen adjusting journal entries related to debt transactions. While staff prepared a number of the above journal entries during the audit, we found corrections were needed to those entries which we provided to staff.

As noted above, all debt service transactions should be recorded timely. Simple analyses of fund account balances and activity should have revealed the missing adjustments. The audit should not be used to reveal unposted journal entries. Without making these corrections during the fiscal year, interim financial reports are inaccurate.

Management's Response:

In fiscal year 2007-08, the responsibility for recording all debt-related accounting transactions was assigned to the Treasury/Debt Management Divisions. Beginning with fiscal year 2008-09, this responsibility is now assigned to the General Accounting Division for those debt issues that have Fiscal Agent cash accounts. All cash transfers are recorded at the time the transfer is completed, and all fiscal agent cash accounts are reconciled monthly.

CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF MATERIAL WEAKNESSES

2008-03 Investments – Review and Reporting

During our review of investment review and reporting policies and procedures, we noted the following:

1. Reconciliation of Treasurer's Report to the General Ledger

We reviewed the reconciliation of the March 2008 Treasurer's Report to the general ledger and found that the reconciliation was not accurate. Although the reconciliation did identify variances with explanations and the responsible person, many of the corrections were not recorded in the general ledger until May 2008, others were scheduled to be made in June 2008, and the amounts reported in the reconciliation did not agree with all of the supporting documentation. The total General Ledger balance for the period differed from the balance reported in the reconciliation by \$36,343,665, which was caused by the following:

- Typo error of \$270,000 for one general ledger account
- Omitted one general ledger account balance of \$9,966,399
- Civic Center fiscal agent accounts totaling \$30,503,830 were misstated
- Municipal Sewer fiscal agent accounts totaling \$100,439 were misstated
- Redevelopment Agency fiscal agent accounts totaling \$4,305,024 related to the 2007 Bonds were misstated
- Debt payments of \$362,700 for the SunTrust lease #4 had not been recorded in the general ledger.
- Fiscal agent investments are labeled "Book Value Treasurer's Report," but the amounts included are "market value" (and the general ledger is at cost)
- In addition, in the March Treasurer's Report, we noted that the balance of "uninvested cash" in one of the fiscal agent accounts related to the Harbor 91 Tax Allocation Revenue Bonds was reported as a U.S. Treasury Bill.

Although an improvement from the March reconciliation, the June 2008 reconciliation of the Treasurer's Report to the General Ledger contained five unreconciled differences that did not include an explanation of the causes or resolutions of the differences. While the reconciling journal entries were posted to the general ledger prior to the start of our audit, the reconciliation should indicate the causes of each of the differences or the journal entry reference for each correction.

An effective reconciliation either locates posting errors in the general ledger or in the Treasurer's Report balances, or confirms that the reported balances are accurate. Based on the significant number of variances not included on the original reconciliations, it appears that a review of the reconciliations is not taking place. The City should immediately implement in-depth review procedures, or ensure that review procedures in place are effective.

In addition, in the Treasurer's Report the City should consider changing the column titled "Book Value" to the "Cost" of investments. This would facilitate the monthly reconciliation since the general ledger is maintained on the cost basis throughout the year.

Finally, the timeliness of the reconciliation and the posting of any necessary correcting entries must be improved. March 2008 corrections should have been posted to the general ledger in April, not May or even June, and June 2008 corrections should have been posted to the general ledger in July 2008.

CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF MATERIAL WEAKNESSES

2008-03 Investments – Review and Reporting (Continued)

2. Investments Reported Should be Accurate

On the June 2008 Treasurer's Report, we noted a \$7.3 million Guaranteed Investment Contract (GIC) that was reported as a "miscellaneous" investment, rather than as a GIC. Errors such as these should be corrected during the review process.

3. Detailed Review Should Take Place and the Review Should be Documented

The City's Treasurer's Report review procedure is that Treasury Manager reviews the Treasurer's Report and then the Finance Director reviews and signs it before presentation to the City Council. We reviewed the October 2007 and March 2008 Treasurer's Reports and noted the Finance Director's initials however, the Treasury Manager did not leave any documentation to show that the review had been performed. We understand that in April 2008 the City started including a reviewing worksheet in the Treasurer's Report file and we did see the reviewing worksheet was included in the April 2008 Treasurer's Report file. In light of the errors noted above, we would like to emphasize the importance of the review process to ensure that the Treasurer's Report is accurate.

Management's Response:

The City of Richmond has put processes in place to correct and explain the reconciliations of the Treasurer's Report to the General Ledger. We have a person to store the statements in a binder, input the data from the statement, then another person to reconcile the statements to the general ledger.

- The typo errors have been corrected.
- The omitted accounts are now in the general ledger.
- Fiscal agent investment amounts are correctly labeled at cost, not market value.
- The "Book Value" column description has been changed to "Cost" to coincide with the general ledger.
- Corrections are being posted in a more timely matter.
- The accounts on the Treasurer's Report are titled correctly.

The Treasury Manager has an authorized signature page that is signed by the Accountant, Manager and Director before the Treasurer's Report goes to the City Council on a monthly basis.

CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF MATERIAL WEAKNESSES

2008-04 Revenue Accounting and Accruals

As we recommended in the prior fiscal year (see 2007-02), as part of the year-end closing process, significant revenue accounts that receive regular payments should be reviewed to ensure that they include 12 monthly remittances and that year-end receivable accruals are treated consistently from year to year. During our testing of certain revenues received from the State we again found the following errors in accounting for these revenues which required correction:

- Sales Tax revenue for May and June totaling \$1,364,192 had not been accrued.
- Measure Q Sales Tax revenue for May and June totaling \$872,760 had not been accrued.
- Sales Tax revenue and Measure Q Sales Tax revenue "clean up" adjustments for June netting to a negative \$242,754 had not been accrued.
- Sales Tax and Measure Q Sales Tax revenues have separate general ledger accounts, however the revenues were recorded in the wrong general ledger account in two separate instances. Sales Tax had been recorded as Measure Q revenue, and Measure Q had been recorded as Sales Tax.

Revenue analyses should be performed throughout the year to ensure that revenue fluctuations are economic results and not the product of miscoding or inconsistent revenue accruals.

Management's Response:

With the help of General Accounting, Revenue Division staff has focused on identifying items that need to be accrued and verifying that the correct object is being used. General Accounting staff processed the actual accrual journal entry. Going forward, all revenues will be placed on a schedule to verify both their correct recordation and their timely posting and more easily identify important decreases or increases to the revenue flows.

CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF SIGNIFICANT DEFICIENCIES

2008-05 Improve Timeliness of Bank Reconciliations

As we recommended in 2005, 2006 and 2007, bank reconciliations are one of the most important internal controls a City can have. This also holds true for investment reconciliations. The City must improve its processes and bring all items up to date and continue to complete the reconciliations and compliance reviews timely on an ongoing basis.

We noted that the City's March 2008 general checking bank reconciliation was not completed until May 23, 2008. Although this is a significant improvement over the prior year, to be effective bank reconciliations must be completed in their entirety as soon as reasonably possible after each month-end, usually within 30 days. We understand that Finance staff is developing procedures to improve the bank reconciliation process, and we did note that the City's April and May 2008 reconciliations were completed within 30 days after month end. However, the June 2008 reconciliation was not completed until October 2008. We still recommend that the City continue to reconcile its bank accounts in a timely manner.

In addition, the bank reconciliations should be reviewed in detail and that review should be documented. We selected two months bank reconciliations to see if the review process was documented. We noted that the City's October 2007 and March 2008 bank account reconciliations included the reviewer's initials, with the exception of the March A/P account and March and October Wellington account reconciliations. We also reviewed the Redevelopment Agency's bank account reconciliations for October 2007 and March 2008 and found that the reviewer did not document its completion. We understand from Finance staff that the original reconciliations were reviewed and initialed, however, due to errors in the reconciliations, they needed to be redone. The updated reconciliations were reviewed but not signed. Finance staff should ensure that all reconciliations are reviewed and that review is indicated on the face of the reconciliation, even if revised.

Management's Response:

In April 2008, the responsibility of reconciling the general account was removed from the accountant who was specifically hired to do it. This function was transferred back to the accountant who used to do it. Reconciliations from October 2007 and onwards had to be reviewed and revised. Six months worth of reconciliations (from October 2007 to May 2008) were completed in one month. In June, the original reconciliation was completed on August 8, 2008, eight days after the deadline. But because there were adjustments affecting cash after it was reconciled, the reconciliation had to be revised and updated to reflect these adjustments.

Currently, the RCRA Finance Manager and staff review, initial, and date the journal voucher request forms. Included with the above process, the RCRA Finance Manager will also review and initial the associated bank statements when applicable for verification that the reviewer documented the bank account reconciliation process.

The preparer of reconciliations now ensures that both the original and updated reconciliations are reviewed and initialed, not just the original.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF SIGNIFICANT DEFICIENCIES

2008-06 General Ledger Access Log

In preparation for our review of internal controls, we requested reports of employee access for key general ledger processing areas and accounts. We reviewed the summary provided by the Information Systems Department personnel and noted the following problems:

- One finance employee should have the ability to park journal entries to the general ledger, but not post journal entries. The employee's access in the log was set up to post journal entries, rather than park journal entries.
- Five employees who were either terminated or transferred to other departments still had active status in the system to park journal entries.
- One employee had access to the Business License Clerk module, but was transferred to a different department and no longer performed that function.
- One employee had access to the Business License Clerk function, however he was terminated in 2006.
- Two employees had access to the Budget function, however they are not budget staff.

As noted in our 2007 management letter comment 2007-06, due to the complexities of the City's system, the City was not able to produce an all-encompassing access log. The City should be able to generate a log to easily monitor employee's access to various modules to ensure the access is authorized and appropriate. In the absence of this report, City staff should periodically review access for key accounts and transaction functions to ensure that employee access is appropriate.

Management's Response:

- The City of Richmond does have in place a process, policy and forms for system access additions/changes/deletes. The policy AP653 covers removing and deleting access when no longer required due to changes in job duties and that notification needs to be done immediately. Periodic communication will be made to Department Heads emphasizing the prompt communication to IT for removal of system and network access in compliance with the policy.
- When employees are terminated we have implemented workflow in the MUNIS ERP system that notifies the Business Systems Manager by e-mail when the termination is approved by the City Manager. The Business Systems Manager will then follow up with the Department Dead notifying them that the employee will have all access to any software applications, e-mail and network access disabled as of the date of termination unless they have any compelling reason to do anything differently. The Business Systems Manager then coordinates with the other personnel in IT to make these changes to the access.
- In the "Security" section of MUNIS (the City's new ERP system operational December 1, 2008) there is a list of each City employee authorized to use MUNIS. In addition, each City employee's authorized roles are listed. A separate part of the "Security" section defines the permissions and data access for each role in MUNIS. Finally, for any changes to an employee's roles or any changes to a role's permissions, MUNIS records in the background, including data on who made the change and when.

CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF SIGNIFICANT DEFICIENCIES

2008-07 Timely Review of Journal Entries

Journal entries used to record monthly general ledger activity or corrections to general ledger activity should be prepared and posted as soon as they are created. We selected thirty journal entries for testing of review and approval procedures and proper posting to the general ledger and noted the following:

- One journal entry dated September 24, 2007 was not entered and posted to the system until December 3, 2007.
- One entry dated October 20, 2007 was not entered and posted to the system until November 30, 2007.
- One entry dated March 10, 2008 was not entered and posted to the system until April 18, 2008.

We were told that the delays in posting the entries above were due to the need for the entries to be reviewed and approved. Depending on the purpose of a journal entry, excessive delays in posting journal entries could result in misstated interim financial reports. Finance staff should review procedures in place to reduce the time between preparation, review and posting. In addition, there should be documentation of the periodic review of "parked" entries to see what is causing the delay in posting any outstanding entries.

Management's Response:

The Finance Department has always maintained a procedure whereby journal entry processing from "parking" to posting is to take place within a specific timeframe; however the prior ERP system allowed one month to close and the subsequent month to open without ensuring that all outstanding journals had been posted from that prior month. This issue has been rectified with the implementation of the new MUNIS ERP system. All journals are entered, reviewed, approved and posted within a fiscal month time frame.

2008-08 Timely Execution of Personnel Action Forms

Personnel Action Forms (PAFs) should be processed efficiently to ensure that payroll records are updated in a timely manner. We selected 25 employees for testing gross payroll calculations. One employee tested had a promotion effective September 13, 2007, but his PAF was not signed and approved by the City Manager until May 2008. Therefore, he did not receive his promotion pay until May 2008 via a retroactive pay correction which was after his last day of work (the employee was terminated in April 2008). During our tests of payroll expenditures related to the Community Development Block Grant Single Audit Program, we selected five employees charged to the program and two pay periods for testing and noted one employee had received a step increase in January 2008, but as of June 30, 2008 the pay rate in the payroll system had not been updated to reflect the revised rate on the PAF.

CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF SIGNIFICANT DEFICIENCIES

2008-08 Timely Execution of Personnel Action Forms (Continued)

The Human Resources Department should work with other City departments to ensure that PAFs are initiated timely, signed and processed on a timely basis in order to have accurate pay rates in the system. In addition, the Human Resources Department and Payroll Department should review pay rates in the system to ensure they reflect pay rates on the most recent PAFs for all employees.

Management's Response:

The City is aware of the problem of retroactive PAFs in the system. We have notified the departmental managers and the administrative support personnel who perform processing roles of this issue. The Human Resources Department has sent out e-mails highlighting this problem and requesting that managers be more conscientious in tracking these actions to ensure that they get done in a timely fashion. In addition, the analysts and the Principal Personnel Analyst have followed up in instances where this has happened and admonished the departments about the problems these types of retroactive actions cause, both in terms of policy and administratively.

2008-09 Deposits Payable Accounting and Control Procedures

Deposits Payable accounts are used to track cash and other payments held for others, such as developers. It is important to properly account for the deposit payable balances, since any unused amounts could result in a refund to the depositor, and amounts spent against a deposit payable in excess of the deposit could result in the need to bill the depositor for additional funds.

A. Deposit Accounting

During the interim phase of the audit we selected six deposits payable for testing of proper supporting documentation and noted the following:

- **One Deposit was a Federal Grant**
One deposit in the amount of \$109,030 from the Richmond Museum Association (Museum) for the Federal Aide Project No. STPLEE-5137 (030) was not actually a deposit. The Museum was to perform the renovations to the Red Oak Victory Ship, while the City was to collect the invoices from the Museum and apply for a grant to help reimburse the Museum for the cost of the project. The balance in the deposit payable was for reimbursements not yet remitted to the Museum. The City was not recording the reimbursement from the grant as revenue and was not recording the payments to the Museum as expenditures. However, based on our review of the grant agreement and other supporting documentation, these transactions were not deposits payable. The City corrected the \$109,030 refundable deposit amount and grossed up all revenues (\$607 thousand in fiscal year 2008) on the general ledger to correctly account for the grant award, however, future grant agreements that involve other agencies should be reviewed in detail to ensure that they are accounted for properly.
- **One Deposit Should Include Interest**
One deposit in the amount of \$50,000 from the Scotts Valley Band of Pomo Indians was dated May 10, 2006. We reviewed the agreement with the Tribe and noted that the deposit was supposed to be allocated interest, however interest had not been added to the deposit in the general ledger to date. Finance staff should calculate and add the interest to the deposit from the date of deposit. All other deposits payable that are required by separate agreements should be reviewed to ensure that they do not need to be included in the allocation of interest.

CITY OF RICHMOND
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SCHEDULE OF SIGNIFICANT DEFICIENCIES

2008-09 Deposits Payable Accounting and Control Procedures (Continued)

B. Deposit Reconciliations Should be Timely

We reviewed the deposits payable detail and noted that deposits related to one event were recorded in two separate accounts. The misclassifications took place in March 2008, however Finance staff caught this mistake while preparing the deposits payable information for the interim audit in July. Finance staff should review the reconciliations of deposits payable throughout the fiscal year to ensure that balances and accounts are accurate.

C. Deposit Negative Balances Should be Resolved

During our review of the March 2008 deposits payable detail we selected one debit (negative) balance and noted that the Redevelopment Agency had incurred charges in excess of the developer's deposit in the amount of \$25,510. Although Agency staff had contacted the developer for payment, as of December 22, 2008, the Agency had not received reimbursement. The City/Agency should develop procedures that ensure that amounts charged to developer deposits do not exceed the amounts on deposit. Work related to the deposit should be discontinued until the developer/depositor replenishes the account.

D. Deposit Activity Statements for Developers/Depositors

We inquired about deposits payable and if statements were periodically issued to the depositor to show activity related to the deposit, and it appears that statements are not issued. The City should consider issuing statements to developers/depositors detailing activity related to the deposit on a periodic basis, such as quarterly. This process would also help to reduce the likelihood of deposit balances becoming negative as noted above.

Management's Response:

- A. The City agrees and will review each grant agreement more closely to ensure each grant is accounted for properly.
- B. The Finance Department has implemented procedures requiring quarterly reconciliations of refundable deposits. This information along with a deposits payable template has been disseminated to all staff responsible for reconciling deposits payable accounts.
- C. The Agency accounting staff will monitor deposits payable on a quarterly basis and they will meet with the project managers on a monthly basis to discuss not only that the project is within budget, but they will also discuss the remaining amount of the developer deposit. When the developer deposit has 20% remaining on the account, the project manager will verbally communicate this to the developers project manager and will give the developer's project manager an invoice (prepared by the accounting staff) requesting the additional 80% to bring the developer deposit to its original amount. The accounting staff will also send this invoice to the developer's corporate office referencing the meeting with the Agency project manager and the developer's project manager. If payment is not received and as the account drops to 5% remaining on the account, a notice will be sent to the developer's corporate office stating the work will be discontinued until the deposit is replenished.
- D. See answer above.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF SIGNIFICANT DEFICIENCIES

2008-10 Loans Receivable Transactions

During our review of the loans receivable detail we noted two loans receivable that had made disbursements in 2006 and 2007 but had not been recorded as loans receivable in those years. The Arbors Preservation loan of \$2 million had been disbursed in 2007 and 2008, and the Wood Development Corporation Loan of \$1.7 million had been disbursed in 2006, 2007, and 2008. As we have recommended in the past, when loan agreements are executed, that should be the flag for City and Redevelopment Agency staff that the loan will need to be recorded. As disbursements are made to the loan recipient, the loan receivable should be recorded on the general ledger.

In addition, City staff should ensure that loans receivable recorded reflect only loan activity that has occurred. We noted that the Arbors Preservation Loan had been recorded in the general ledger at the full approved loan amount, rather than total loan disbursements to date. As a result, we had to reduce the loan receivable balance by \$777 thousand.

Management's Response:

The following procedure is now in effect. As soon as loan documentation is signed and recorded, a copy of this documentation is given to the RCRA Finance Manager from the assigned project manager. The RCRA Finance Manager will work with the accountants to ensure the proper recording of the loan and the update on the loan receivable sub schedule. At the end of the fiscal year, the RCRA Finance Manager and the accountants will meet with the project managers to ensure that all receivables that are booked agree with what is in the project files.

2008-11 Unspent Lease Proceeds

As we noted in our prior year recommendation (2007-04), the City executed a lease in early fiscal 2007 in the amount of \$2.66 million for the purchase of information technology equipment. We understand that capital items have been purchased that could have and should have been funded through drawdowns from the capital lease, but they were not. We understand that City staff still has not tracked down all of the equipment to be purchased with this lease and reimbursement drawdowns of only \$164 thousand had been requested from the escrow agent to date. The City continues to make debt service payments on this lease and the balance of the lease payable was only \$1.6 million at June 30, 2008. The City should determine whether it is cost effective to continue to pay debt service on the lease if the capital assets are not going to be purchased in the near future.

Management's Response:

The entire lease has been drawn down in fiscal year 2009. In the future, staff will work more closely with the departments to ensure timely purchases with lease proceeds.

CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF OTHER MATTERS

2008-12 Payroll Controls and Review

During our review of payroll policies and procedures, we noted the following:

A. Items Missing from Payroll Register

We selected twenty-five employees for testing gross payroll calculations. The payroll register for pay period May 1 – May 15, 2008 was missing information for two employees selected for testing. One of the employees had a \$451.69 FLSA grave shift earning and a \$23.00 medical claim that were correctly recorded in the payroll system, but did not appear on the pay register. Another employee had a \$25.00 medical claim that was also missing from the payroll register but was correctly recorded in the payroll system. These errors could lead to confusion between the payroll department and the City's employees. We recommend that every payroll register include all necessary line items that the employees are being paid, and any such discrepancies be eliminated or documented each pay period.

B. Review of Payroll Should be Documented

During our review of payroll procedures in place, we were told that the payroll register is reviewed by the Payroll Lead. However, we looked at the October 2007 and March 2008 payroll registers and found that the review was not documented. We would like to emphasize the importance of the review process and recommend that City staff leave a trail of the review in order to provide evidence that the control is in place. Payroll staff should ensure that all payroll registers are reviewed and that review is indicated on the register, or in some other formal manner determined by staff.

Management's Response:

- A. All pay codes as well as deduction codes are now accounted for on the payroll register.
- B. Once the payroll is complete, the Payroll Supervisor is notified. After reviewing the payroll the Payroll Supervisor signs off on the form, from there the form is given to the Finance Director who initials the form and the payroll staff continues with the process of cutting the checks and automatic deposit advises. This document is kept with the automatic deposit file and can be reviewed at any given time.

2008-13 Accounts Payable and Procurement Card Controls and Purchasing Policy Update

During our review of accounts payable policies and procedures, we noted the following:

A. Purchasing Policy Sealed Bid Requirement

Chapter 4 of the City's Procurement Policies and Procedures Manual requires that formal bids be used for all materials and equipment costing \$25,000 or more. We selected 30 disbursements for testing and four disbursements appeared to require the formal bidding process, but we were not initially provided with evidence that it had occurred. After further inquiry, we found that one disbursement had been formally bid, one disbursement was for an approved sole source purchase, one disbursement was for a project that had been approved more than 5 years earlier, and one disbursement was to a vendor that was on an informal bidding list. Purchasing files should readily contain information that provides evidence of compliance with the City's policies. It should not be necessary to make multiple requests for supporting information that shows compliance.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

**2008-13 Accounts Payable and Procurement Card Controls and Purchasing Policy Update
(Continued)**

B. Preventing the Use of Duplicate Invoice Numbers

During our review of internal controls and processes for accounts payable, we inquired about how the City's system prevents employees from paying duplicate invoices. We noted that the system's reaction to a duplicate invoice was a dialogue box warning the employee that the invoice number has already been processed. However, this warning can be ignored and the invoice number can still be processed. With the implementation of the new finance system, the City should determine whether a stronger control is available in the system to prevent the use of a duplicate invoice.

C. Primary Office Supply Vendor – Procurement Cards

We selected 32 procurement card transactions for testing of supporting documentation and compliance with City policies. We noted 4 purchases were for office supplies using three different vendors. The City's procurement card purchasing policy indicates that there should only be one primary office supplies vendor for all employees to use when purchasing office supplies. We understand that the City's contract with its previous office supply company expired and therefore the use of one vendor was not being enforced. The City should either obtain a contract with a new office supply company or change the purchasing policy to reflect current practices.

D. Purchase Descriptions – Procurement Cards

During our testing of the procurement card transactions we noted that the descriptions for many of the purchases were very brief and didn't always contain the purpose for the purchase. It is difficult to decipher the invoices or receipts if you are not familiar with the proper terminology. Without clear documentation of the items purchased and the purpose, this could lead to miscoding of the transactions. The Purchasing Staff should consider requiring employees to include complete descriptions and the purpose of purchases that are unclear with the backup for the procurement card purchases.

E. Purchasing Policy Does Not Include Redevelopment Agency Contract Approvals

The City's purchasing policy, dated October 28, 2003, requires Council approval of purchases over \$10,000. However, the Council/Board purchase approval for the Redevelopment Agency was revised to \$50,000 with Resolution Number 05-26. The City should consider updating the Purchasing Policy to include differences between Redevelopment Agency and Non-Redevelopment Agency purchases to eliminate any confusion for City staff.

Management's Response:

- A. Yes, purchasing files should readily contain information that provides evidence of compliance with the City's policies. It is the Purchasing Division's policy that a Purchase Order is not issued until all supporting documentation is provided to the Purchasing Division.
- B. Once the message is received, the new MUNIS general ledger system does not allow you to continue to input the Purchase Order or the Green Stamped invoice.
- C. The Purchasing Division is currently evaluating different office supply vendors to obtain the best possible office supply contract for the City by April 2010. Once the City secures a contract, the Purchasing Division will be enforcing that all City employees obtain their office supplies from the primary supplier.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

**2008-13 Accounts Payable and Procurement Card Controls and Purchasing Policy Update
(Continued)**

- D. Yes, the Purchasing Division is now requiring that employees include complete descriptions and the purpose of purchases for the procurement card purchases. Cardholders are now assigning and allocating their charges in the US Bank site which allows 128 characters for descriptions.
- E. Yes, the City will update the Purchasing Policy no later than March 2010 to include the differences between the Redevelopment Agency and Non-Redevelopment Agency purchases to eliminate any confusion for City staff.

2008-14 Accounts Receivable Policies and Procedures

During our review of accounts receivable policies and procedures, we noted the following:

A. Port Invoicing

We selected 20 cash receipts for the Port Enterprise Fund from a detailed listing of transactions for testing of supporting documentation. One invoice to Auto Warehousing Corporation (AWC) for \$101,633 for rent for September 2006 through March 2007 was not sent to AWC until October 15, 2007. While we understand that the Port was waiting for information from a vendor to determine how many cars had been stored at the facility which affects the rental fee, staff should review procedures to ensure that recurring invoices, such as rent, are sent soon after the services are provided. Waiting this long to bill a customer could lead to confusion between the Port, Finance, and the customer.

B. Enterprise Fund Bills are Posted to the General Ledger without being Reviewed

During our review of procedures in place for processing Enterprise Fund accounts receivable billings, we were told that the bills were not reviewed prior to mailing and entry into the general ledger/receivables system. All customer billings should be reviewed and approved prior to issuance.

C. Accounts Receivable Collectability Review

The City's Administrative Manual, policy number AP251 dated August 22, 1999 – Procedure C, indicates that accounts receivable should be reviewed and uncollectible amounts should be written off (with approval) on a quarterly basis. The City's last accounts receivable review and write off of uncollectible amounts was approved by Council on April 17, 2007 and covered a period of 3 years as of December 2006. Although the City does establish an allowance for doubtful accounts at the end of each fiscal year, we understand there has been no approved write-off of uncollectible amounts since that date. The City should consider following the requirements of its Administrative Manual Policy and review accounts receivable on a quarterly basis, or revise the Policy to reflect current practices.

D. Accounts Receivable Business Area Balancing Account

The accounts receivable account termed "business area balancing" contains four receivable amounts totaling \$423,012. The accounts date to fiscal years 2003 through 2006 and had no activity during fiscal year 2008. The City should determine whether these balances are collectible.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2008-14 Accounts Receivable Policies and Procedures (Continued)

Management's Response:

- A. The one time payment received from AWC for temporary usage of additional space was accrued in fiscal year 2006-07 in order to reflect the revenue. The Port is currently billing on a timely basis to all the customers. The Hyundai and Kia operations terminated July 1, 2009.
- B. There is no approval workflow available in MUNIS for General Billing. There are only notifications when an invoice is posted. Authorizations will be set up where a user is only able to enter an invoice but will not be able to post the invoice. Another user with authorization to output/post invoices will review and post these invoices.
- C. The goal of the Revenue Division is to take to Council, on a bi-annual basis (January & June) a list of items that need to be written off. The Revenue Division will also contract with a collection agency for all items that will be written off as per the accounts receivable manual.
- D. With the implementation of MUNIS, the City is no longer using the Business Area balancing account. The balances in the AR Business Area Balancing Account were uploaded to AR Misc. Accounts Receivable. City staff will follow up on the collectability of the items noted.

2008-15 Interest Income Allocations

During our review of interest income allocation policies and procedures, we noted the following:

A. Allocation to Closed Funds

When reviewing the supporting documents for the May 2008 interest allocation, we noted that the interest apportionment schedule's comment column states "Move to xxxx" or "Post to xxxx". We understand that these changes are due to allocations to cash balances in funds that are closed and they indicate the need for an entry to the correct fund. We also understand that the cash balances (positive or negative) are caused by payroll and other expense allocations being posted to the closed fund. In order to reduce workload and strengthen internal controls, once a fund is closed, Finance staff should notify the applicable people/departments that future charges to the fund will not be allowed. In addition, Finance staff should investigate the ability to lock the cost center function in the SAP system so future postings to closed funds do not recur, and investigate whether the new finance system will allow funds to be closed without the chance of subsequent postings to the closed fund.

B. Consider Streamlining the Allocation Process

We also noted that the City prepares three separate journal entries for the monthly allocations: interest income, accrued interest at purchase, and bank fees. Since the accrued interest at purchase and bank fees are immaterial, and the accrued interest at purchase is eliminated with the first interest receipt from an applicable investment, the City should consider netting these items with interest income prior to calculating the interest allocation. This would eliminate the need for two long and complex entries each month.

Management's Response:

The new ERP system has the capability to truly inactivate funds. The City agreed with the streamlining the interest allocation process and had implemented it effectively in fiscal year 2008-09.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2008-16 Loans Receivable Lien Priority

We understand that the City's goal for the Community Development Block Grant program is to be the second lien priority on the recorded deeds of trust. We also understand that the actual lien priority for loans can be in the third or fourth position. During the testing of loans for approval and supporting documentation, we selected three new CDBG loans and we were unable to determine the lien position for these loans. While the City did have copies of the recorded deeds of trust, there was no documentation of the City's lien position in the loan files. The City should document the lien position in the loan files.

Management's Response:

Upon the recording of the deed of trust, staff will inquire at the recorders office what the lien position is of the loan that was recorded by the City. Staff will then record this information along with the date the information was obtained and the individual they spoke with at the recorders office in the client file.

2008-17 Authorized signers for Bank and Investment Accounts

The Deputy Finance Director left the City on July 1, 2008, however as of December 2, 2008 he was still listed as an authorized signer on the City's Mechanics Bank account and Local Agency Investment Fund. The City should change signers immediately upon the departure of applicable employees in order to safeguard City's cash and investments.

Management's Response:

The signature cards for the Mechanics Bank account and Local Agency Investment Fund for the City have been updated to remove employees no longer with the City. The signature cards now reflect active authorized employees of the City.

2008-18 Richmond Police Athletic League Receivable

The Richmond Police Athletic League (PAL) owed the City \$322 thousand as of June 30, 2008 for reimbursement of various payroll charges dating from 2004 to 2006. We understand that the City has billed the PAL, but payments have not been received to date. The City should determine whether the balance is collectible and if so, establish a repayment schedule with the PAL.

Management's Response:

The amount due by the Richmond Police Athletic League (PAL) is uncollectable and will be written off in fiscal year 2009-10.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2008-19 Cost Recovery Special Revenue Fund Deficit

The Cost Recovery Special Revenue Fund's fund balance deficit grew from \$425 thousand at June 30, 2008 to over \$2.7 million at June 30, 2009. The fund records the receipt and use of monies for services provided to the public and developers. However, in this economic downturn the City should determine whether alternative funding sources are available to the Fund in the event permit and other associated activity is not sufficient to fund the operations of the Fund. While we understand that the City has established a reserve in the fund that will retain fees collected during high permit volume to cover shortfalls that accompany low permit activity, this policy does not address the elimination of the fund deficit. The City should determine how the fund deficit will be eliminated.

Management's Response:

Operating transfers from the capital project fund to reimburse for grant funded projects in the Engineering Cost Recovery Fund have been established. Due to the downturn in the economy, reductions in projected license permit and fee revenue were included in the fiscal year 2009-10 budget. In addition, the City has reduced personnel costs in the Cost Recovery Funds in fiscal year 2009-10 and will monitor fund revenue more closely to ensure the expenditures do not exceed the revenue. Additional expenditure reductions will be identified as needed. The City will work out a repayment agreement to recover the deficit.

2008-20 Establish Repayment Terms for the Redevelopment Agency Advance to the Civic Center Project Capital Projects Fund

During fiscal year 2007 the Redevelopment Agency advanced \$2 million to the City's Civic Center Project Capital Projects Fund for use in the Civic Center project. The balance of the advance was unchanged during fiscal year 2008 and repayment terms have not yet been established. The City and Agency should establish repayment terms for the advance and whether the advance should bear interest.

Management's Response:

City Manager, Director of Finance, and Director of RDA are to meet with City Legal Counsel in fiscal year 2008-09 after the project is complete to set repayment terms of this advance, if necessary.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2008-21 Capital Asset Ownership Indicator Tags

One of the City's federal grants was used to purchase six generators for the City's fire department during the year ended June 30, 2008. It is the City's policy to "tag" City equipment with metal barcode tags, however when we visited the fire stations to physically inspect three of the generators, a barcode tag had been affixed to only one of the three generators. The City should ensure that the metal barcode tags are installed on all applicable City-owned equipment to monitor where the equipment is stored and to ensure the City is still in possession of the purchased equipment.

Management's Response:

The purchase of the six generators listed above was done directly by the fire department. The Equipment Services Department was not included in the purchase or the fixed asset tags. The asset tags would have been shipped directly to the purchasing department. The generators referred to above are fixed generators (not moveable) that are part of each firehouse that have an asset number but not an equipment identification number. This is not mobile and or motorized equipment that would normally be purchased or tracked through Equipment Services. Any piece of equipment requiring maintenance and service is put into the fleet by assigning an equipment identification number. None of these generators were included in the fleet with an equipment number as they are not in the Equipment Replacement Internal Service Fund. Equipment Services uses an equipment identification number to track all equipment. The asset tag number is noted in Faster, our fleet software and the actual tags are put into the equipment file by their identification number. The tags are not physically installed on the vehicle itself so that we do not have to worry about a tag that is weathered and falls off or is removed. None of our City vehicles currently have asset tags installed on them but they are all easily identifiable by their equipment identification number. The asset number would have to be looked up in the computer or in the files themselves.

2008-22 Redevelopment Agency Construction in Progress Projects

The Redevelopment Agency has capital projects in progress with total costs to date over \$41 million. Although most of the projects were in process at the beginning of the fiscal year, none of them had been completed during the fiscal year, and a number of projects had no activity during the fiscal year. The Agency should review the detail of its projects in progress to determine whether the projects have been effectively completed and placed in service. Those projects should be transferred to capital assets.

Management's Response:

On a quarterly basis, the Director of the Redevelopment Division and the Director of the Housing Division submit status reports to the RCRA Finance Manager and the City's Finance Department. When a project is within 25% of being completed the RCRA Finance Manager will meet with the appropriate Director to determine when the project will be completed. As the date approaches, the RCRA Finance Manager will meet with the appropriate Director to determine if the project is completed. Upon completion, the project will then be transferred to a capital asset.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2008-23 Review the Repayment Terms of the General Fund's Advance to the Port Enterprise Fund

The General Fund advanced the Port Enterprise Fund \$17,039,855 in prior years and established a repayment schedule that includes a payment of \$6.3 million due in fiscal year 2009. However, the Port does not appear to have the resources available to make such a payment. At June 30, 2008 the Port Enterprise Fund had unrestricted cash and investments of only \$1.9 million and net assets of only \$3.3 million. The City should review the agreement with the Port to ensure that the repayment schedule is realistic and inline with the expected available revenues of the Port.

Management's Response:

The Memorandum of Understanding needs to be redone. The payment of \$6.3 million did not happen and the fiscal year (FY09-10) payment of \$50,000 was taken out of the budget in order to have a balanced budget.

2008-24 Remit Subregional Transportation Mitigation Program Fees on a Quarterly Basis

The City and other agencies in Contra Costa County collect Subregional Transportation Mitigation Program (STMP) fees from developers on behalf of the West Contra Costa Transportation Advisory Committee (WCCTAC). The fees are to be remitted to WCCTAC on a period basis. However, at June 30, 2008 the City had collected fees from developers totaling \$267,210 for the period July 1, 2007 to June 30, 2008 and those fees were not remitted to WCCTAC until September 2008. We understand that the staff in charge of the STMP accounting departed the City and the duties were not reassigned. The STMP fees should be remitted to WCCTAC on a quarterly basis, consistent with the requirements of the STMP. And, staff departures or reassignments should be accompanied by an immediate reassignment of the employee's duties.

Management's Response:

The previous Deputy Finance Director, was the one handling the STMP quarterly report before his departure from the City on July 1, 2008. An Accountant was assigned this task in September 2008 and that was the time that the City remitted the total STMP fee of \$267,210 for fiscal year 2007-08 to WCCTAC and from there on the City remits payment on quarterly basis.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2008-25 SAS 70 Audits for Service Providers

The City should periodically review reports available from its service providers to ensure that the service providers are using proper internal controls and subjecting themselves to review or audit. We understand that the City's investment service providers (Union Bank of California, Mechanics Bank, SunTrust Leasing, Bank of New York, Zions Bank, and Wellington Trust Co.) were engaged in SAS 70 audits in fiscal year 2008, however the City did not review the SAS 70 audit reports for these banks. The purpose of the SAS 70 audit of a bank is to form an opinion of the Bank's controls related to its processing of transactions for its custody services, security lending, and corporate trust department clients. Although SAS 70 reports are not required, the City should request copies of the SAS 70 audit reports from the banks annually and review the reports if they have been completed to ensure that the bank's controls are acceptable to the City's standards.

Management's Response:

The City of Richmond has requested the SAS 70 Audit Report from its service providers. We have received SAS 70 Reports from a number of banks. Most broker-dealers are exempt from this reporting, so they have provided their Focus Reports and audited financial statements. The reports received have been reviewed and meet the City's standards.

2008-26 Capital Asset Inventory

The City has not inventoried its capital assets in at least the last four years. The City should consider performing a physical inventory of Capital Assets. At a minimum, each type or class of assets should be inventoried on a rotating basis. As an alternative, on an annual basis, each department could be required to review their entire listing and document any changes or revisions to the assets. With the move to the new City Hall, City staff should take advantage of the opportunity to complete a physical inventory of all capital assets as they are moved or disposed.

Management's Response:

The City of Richmond does not have an Inventory Management Specialist to oversee either departmental inventories on a rotating basis or the inventory of capital assets. Funds were set aside in the original FY 09/10 budget to hire a firm to perform the initial physical inventory of Capital and Controlled assets and provide the information to the respective departments to begin the inventory of departmental assets on a rotating basis. The City budget was revamped on October 18th and funds were reallocated to higher priority needs. The City has committed to revisit this issue during the FY 09/10 mid-year budget review or the FY 10/11 budget process.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2008-27 Conflict of Interest Statements and Code

The City Clerk's office maintains a control log for Council members, Board members, Commission members, and all applicable department designees. The Conflict of Interest Code has designated the Clerk as the Filing Officer, which indicates that the Clerk should maintain the logs. However, since the most recent Conflict of Interest Code was adopted by the Council in October 2000, some of the positions that were included in the Code have been eliminated and some have been added, so it is unclear if the logs are correct. We reviewed the control log as of July 28, 2008 and found that 36 employees' forms were submitted after the April 1, 2008 filing deadline. The latest submission was July 22, 2008.

We understand that City is in the process of updating the Code and intends to have the update completed by December 31, 2008. The City should update the Conflict of Interest Code as positions change. In order to ensure the required forms are submitted in a timely manner, the City should consider including penalty terms in the Code. In fact, we found the following information on the FPPC website:

The FPPC and agencies have the authority to levy penalties when a statement of economic interests is not filed on time. The FPPC also has the authority to levy administrative fines of up to \$5,000 per violation of the Political Reform Act, or to seek civil penalties in the courts. The FPPC does not have the power to bring criminal charges but may refer cases to another law enforcement authority such as a district attorney.

Agencies must amend their conflict-of-interest codes when necessary to add or delete designated positions and disclosure categories. Conflict-of-interest codes are reviewed every two years. If an employee believes the amount of disclosure required for his or her position should be revised, those concerns can be addressed by the agency, including during the review process.

The City should also inform all applicable employees of the importance of filing the conflict of interest statements in a timely manner.

Management's Response:

Resolution number 136-08 was adopted December 16, 2008, updating the City's Conflict of Interest Code.

2008-28 Information Technology Best Practices Recommendations

We conducted an Information Systems Review with our audit which encompassed the financial information system and the network environment that houses it. We expanded our work in previous years beyond simply looking at financial information systems as a result of greater risks of unauthorized access caused by overall industry growth of web-based commerce and internet based financial systems. Internal controls that are present in the overall network environment have become more important and relevant to understanding the internal controls over the financial system. We believe Information System controls must be continuously improved and enhanced to stay ahead of the ever increasing sophistication of hackers and criminals.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2008-28 Information Technology Best Practices Recommendations (Continued)

Currently, there are no Information Technology standards to which local governments are required to conform. Indeed there are a wide variety of informal guidelines and suggested controls from many different organizations which local governments can use to implement appropriate controls to ensure adequate security over information technology. Our Information Technology staff have reviewed these informal guidelines and concluded that the certification and accreditation framework developed by the National Institute of Standards and Technology (NIST) for the Federal Information Security Management Act (FISMA) are the most appropriate for local government. NIST and FISMA represent the minimum security requirements for federal government agencies information systems. We understand the U.S. Department of Justice recommends these for local governments. Our procedures included performing an external network scan based on NIST criteria and in determining that internal control provides for:

- Internet access defenses including hacker prevention, detection and deterrent systems
- Security of data from physical or network access
- Adequately protecting data from unauthorized internal access
- Reasonable measures to ensure continuation of service

While the results of our work did not indicate material weaknesses, we noted a few areas which could be improved. A summary of these recommendations which we believe are "best practices" are as follows:

- A. *Payment Card Industry Compliance* – The City is not in compliance with the Payment Card Industry Data Security Standard (PCI-DSS). Any organization that processes credit cards, is required to comply with PCI-DSS, even if the processing is outsourced. Failure to meet compliance results in higher transaction fees and liability if a security breach is found. Because the City accepts credit cards as a form of payment, the City must be compliant with the applicable controls.
- B. *General Information Systems Controls* – We reviewed the compliance of the City's information systems with the NIST information security standards based on a moderate risk system. The NIST standards include 210 control areas and we noted only 3 moderate controls that did not appear to be in place. A separate report of those controls was provided to the City's IT and Finance personnel. Although there is no compulsory IT standard required for local governments, NIST encourages state, local and tribal governments to consider the use of these guidelines, as appropriate. We recommend the City choose an appropriate industry standard like NIST to help plan, organize and review information security. In addition, the City should review the 3 controls that were not in place to determine whether there are other mitigating controls in place that reduce the potential risk noted, or if additional procedures would be deemed necessary.

Management's Response:

- A. The City is now in compliance with the Payment Card Industry Data Security Standard for credit card payments it processes.
- B. The City is studying the NIST standards and working on implementing those standards that make sense for the City as the City was already in compliance with 207 out of 210 control areas at the time of review.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

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2008-28

Information Technology Best Practices Recommendations (Continued)

The three controls for review not currently in place are:

- **SYSTEM USE NOTIFICATION:** The City is willing to accept the risk of not having this notification appear on logging onto the City's network and systems.
- **SECURITY CERTIFICATION:** The City is studying the security certification process and working on adopting a certification process that is appropriate to the City's information systems environment.
- **PERSONNEL TERMINATION:** This control has been implemented in the new MUNIS ERP system. When employees are terminated we have implemented workflow in the MUNIS ERP system that notifies the Business Systems Manager by e-mail when the termination is approved by the City Manager. The Business Systems Manager will then follow up with the Department Head notifying them that the employee will have all access to any software applications, e-mail and network access disabled as of the date of termination unless they have any compelling reason to do anything differently. The Business Systems Manager then coordinates with the other personnel in IT to make these changes to access.

CITY OF RICHMOND
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NEW GOVERNMENTAL ACCOUNTING STANDARDS BOARD PRONOUNCEMENTS:

The following comments represent new pronouncements taking affect in the next few years. We cite them here to keep you abreast of developments:

**2008-29 GASB Statement No. 51 Accounting and Financial Reporting for Intangible Assets
(Effective for fiscal 09/10) - Retroactive Application Required**

Governments have different types of intangible assets, such as easements, water rights, patents, trademarks, and computer software. Easements are referred to in the GASB 34 description of capital assets which has raised questions about whether and when intangible assets should be considered capital assets for financial reporting purposes.

The absence of specific authoritative guidance has resulted in inconsistencies in the recognition, initial measurement, and amortization of intangible assets among governments. The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets to reduce inconsistencies and enhance comparability.

A summary of the statement:

- Intangible assets should be classified, accounted for and reported as capital assets, unless excluded from the scope. Guidance in this statement is in addition to existing capital asset guidance.
- GASB 51 specifically addresses the nature of intangible assets.
 - *Lack of physical substance.* An asset may be contained in or on an item with physical substance, for example, a compact disc in the case of computer software. An asset also may be closely associated with another item that has physical substance, for example, the underlying land in the case of a right-of-way easement. These modes of containment and associated items should not be considered when determining whether or not an asset lacks physical substance.
 - *Nonfinancial nature.* In the context of this Statement, an asset with a nonfinancial nature is one that is not in a monetary form similar to cash and investment securities, and it represents neither a claim or right to assets in a monetary form similar to receivables, nor a prepayment for goods or services.
 - *Initial useful life greater than one year.*
- GASB 51 excludes:
 - Assets acquired or created primarily for the purpose of directly obtaining income or profit.
 - Assets resulting from capital lease transactions reported by lessees.
 - Goodwill created through the combination of a government and another entity.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

**2008-29 GASB Statement No. 51 Accounting and Financial Reporting for Intangible Assets
(Effective for fiscal 09/10) - Retroactive Application Required (Continued)**

- Recognition of an intangible asset occurs only if it is considered identifiable. That is when either of the following apply:
 - The asset is separable from the government. That is it can be sold, transferred, licensed, rented, or exchanged.
 - The asset arises from contractual or other legal rights, regardless of whether transferable or separable.
- Specific conditions must present to recognize internally generated intangibles. Capitalization of costs begins after all of the following criteria are met:
 - Determination of specific objectives of the project and the nature of the service capacity expected upon the completion.
 - Demonstration of the feasibility that the completed project will provide its expected service capacity
 - Demonstration of the current intention, ability, and effort to complete or continue development of the intangible asset.
 - Internally generated computer software is used as an example in applying the specific conditions approach.
- Amortization lives are addressed:
 - Limited by contractual or legal provisions.
 - Renewal periods for rights may be considered if there is evidence that the government will seek and be able to achieve renewal and that any anticipated outlays to be incurred as part of achieving the renewal are nominal. Such evidence should consider the required consent of a third party and the satisfaction of any conditions required to achieve renewal.
 - An indefinite life (no amortization) is permitted so long as there are:
 - No limiting legal, contractual, regulatory, technological, or other factors, and
 - No subsequent change in circumstances.
 - A permanent right-of-way easement is an example.

Retroactive Application -- For GASB 34 Phase I & II governments, retroactive reporting is **required** for intangible assets acquired in fiscal years ending after June 30, 1980. Retroactive reporting is not required for intangible assets with indefinite useful lives as of the effective date of this Statement, nor for internally generated intangibles.

Retroactive reporting for Phase III governments is not required.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

**2008-29 GASB Statement No. 51 Accounting and Financial Reporting for Intangible Assets
(Effective for fiscal 09/10) - Retroactive Application Required (Continued)**

Management's Response:

The City will implement the provisions of the Statement in fiscal year 2010, if applicable.

2008-30 GASB Statement No. 53 Accounting and Financial Reporting for Derivative Instruments (Effective for fiscal 09/10)

This Statement is intended to improve how state and local governments report information about derivative instruments in their financial statements. Specifically, GASB 53 requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting (proprietary and entity-wide financial statements). Governments enter into derivative instruments as investments; as hedges of identified financial risks associated with assets or liabilities, or expected transactions (that is, hedgeable items); or to lower the costs of borrowings. Governments often enter into derivative instruments with the intention of effectively fixing cash flows or synthetically fixing prices. Common types of derivative instruments used by governments include interest rate and commodity swaps, interest rate locks, options (caps, floors, and collars), swaptions, forward contracts, and futures contracts. In addition, this standard addresses hedge accounting requirements.

Management's Response:

The City will implement the applicable provisions of the Statement in fiscal year 2010.

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**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR MATERIAL WEAKNESSES

2007-01 Start Now to Prepare for the 2008 Year End Close

The City issued its 2006 Comprehensive Annual Financial Report (CAFR) in February 2007, a one-month improvement over 2005. And, the Redevelopment Agency was not able to file its financial statements before December 31, 2007, in time to meet the filing deadline with the State Controller's Office. As we recommended in 2005 and 2006, significant improvement is still needed, and the Finance Department must continue to improve the timeliness and accuracy of the closing of the books. Some of the major tasks that need accomplished include:

- A. Finance should continue to strengthen the monthly reconciliation and analyses of accounts so that errors can be discovered and corrected on a timely basis and the work required to close the books is reduced accordingly. We had 81 adjusting journal entries in the fiscal year 2005 audit, 81 adjusting journal entries in the fiscal year 2006 audit, and 70 adjusting journal entries in the fiscal year 2007 audit. Many of these entries related to transactions that should have been posted during the fiscal year and were not related to the year-end closing items.
- B. Account analysis should occur throughout the year and not be left until the audit commences. We prepared analytical review questions as part of the year-end audit and found that staff responses to those questions resulted in 17 of the adjusting journal entries noted above. Finance staff did perform variance analyses on all of the funds for the first time this year, but those analyses resulted in staff identifying only one adjusting journal entry.
- C. Finance staff should build upon these first attempted analyses. Fluctuations of significant balances should be scrutinized to determine if a change or lack of change is supported and to determine if any errors or corrections are incorporated prior to the year-end audit. The analyses should take place for both balance sheet and income statement accounts. Any negative balances should be investigated and corrected, and new financial statement line-items should be analyzed to ensure they are new transactions, and not misclassifications.

Journal entries proposed by staff during the fiscal year should be reviewed in detail and approved prior to posting. The preparation of a journal entry should include a review of the before and after affect the entry has on the general ledger. We found that staff often proposed entries and corrections without looking at the impact on the general ledger which can result in the need for an additional correcting entry. Also journal entries must be reviewed to ensure they balance within the fund and in total prior to posting, otherwise the system posts automatic "auto balancing" entries which have to be corrected manually.

We selected 15 journal entries posted during the fiscal year to test for proper approval and supporting documentation. One of the journal entries totaling \$6,914,958 included supporting documentation that supported the amount, but the journal entry form did not have the approving employee's signature. All journal entries should be reviewed and approved on the form, as required by City policy, before being posted to the general ledger.

While the ultimate goal of the Finance Department should be to have no adjusting journal entries result from the audit, at a minimum the previous year's adjusting journal entries should be used as a tool to ensure that the same mistakes are not repeated. We did not find this to be the case during the fiscal year 2006 or 2007 audits. Review and analysis should take place at every level and many of the following comments have a common theme relating to the need for stronger supervision, review and detailed analysis.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR MATERIAL WEAKNESSES

2007-01 Start Now to Prepare for the 2008 Year End Close (Continued)

Current Status:

- A. Implemented
- B. Ongoing
- C. Implemented

2007-02 Revenue Coding and Accruals

As part of the year-end closing process, significant revenue accounts that receive regular payments should be reviewed to ensure that they include 12 monthly remittances and that year-end receivable accruals are treated consistently from year to year. During our testing of certain revenues received from the State we found the following errors in accounting for these revenues which required correction:

- Sales Tax revenue for May and June totaling \$1,130,330 had not been accrued.
- Measure Q Sales Tax revenue for May and June totaling \$651,728 had not been accrued.
- Sales Tax revenue and Measure Q Sales Tax revenue "clean up" payments for June totaling \$789,236 had not been accrued.
- Sales Tax and Measure Q Sales Tax revenues have separate general ledger accounts, however the revenues were recorded in the wrong general ledger account in five separate instances. Sales Tax had been recorded as Measure Q revenue, and Measure Q had been recorded as Sales Tax.
- Measure C revenue for fiscal year 2007 in the amount of \$1,218,252 had not been accrued
- Secured Property Tax revenue of \$237,471 had been recorded in the incorrect general ledger account as Unsecured Property Tax.
- Gas Tax revenue of \$148,997 that should have been recorded in the Gas Tax Special Revenue Fund had been accrued as Motor Vehicle License Fee revenue in the General Fund
- Gas Tax revenue included thirteen months of revenue, therefore an accrual of \$171,458 had to be reversed
- Gas Tax revenue in the amount of \$67,397 had been accrued twice
- Utility User's Tax Revenue in the amount of \$943,385 had been recorded twice

Revenue analyses should be performed throughout the year to ensure that revenue fluctuations are economic results and not the product of miscoding or inconsistent revenue accruals.

Current Status:

Implemented

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR MATERIAL WEAKNESSES

2007-03 Cash and Investments

As we recommended in both 2005 and 2006, bank reconciliations are one of the most important internal controls a City can have. This also holds true for investment reconciliations. We continue to stress the importance of properly accounting for all transactions related to cash *and* investments and properly reporting those transactions and outstanding balances. This includes ensuring compliance with the Government Code and the City's own Investment Policy. The City must improve its processes and bring all items up to date and continue to complete the reconciliations and compliance reviews timely on an ongoing basis.

During the audit, we noted a significant number of problem areas related to cash and investments. We have segregated our findings by type below:

A. Bank Reconciliations

To be effective, bank reconciliations must be completed in their entirety as soon as reasonably possible after each month-end, usually within 30 days. Errors and unreconciled differences must be researched, understood and corrected immediately, or they will cause additional errors. Differences which result from program or procedural errors, such as duplicate postings or mispostings, are especially important because their underlying cause must be corrected to prevent more of the same error.

During the last two fiscal years, the City had worked to bring the bank reconciliations current, but ended each fiscal year with unreconciled differences of less than \$7 thousand. During those audits, our questioning of various reconciling items resulted in revised bank reconciliations. This pointed to a problem with the bank reconciliation process. During the interim phase of the June 30, 2007 audit, which took place in July 2007, we found that the bank reconciliations had been completed only through May 2007, and there was still an unreconciled difference at that time.

During the year-end phase of the audit we found that City staff had re-performed the bank reconciliations for the entire fiscal year and in November 2007 were finalizing the June 2007 bank reconciliation. However, City staff's finalization of that bank reconciliation and our testing of that bank reconciliation found the following errors:

- Checks reported on the outstanding check listing totaling \$463,304 that had actually cleared the bank in 2006.
- Certain checks had been uploaded from the bank twice in to the general ledger system.
- A deposit in the amount of \$137,592 had been recorded as revenue twice in the general ledger.
- A debt service payment of \$42,343 had not been recorded in the general ledger.

An in-depth review of each bank reconciliation should be performed and indicated on the reconciliation. That review should include selected testing of the reconciling items such as outstanding checks to ensure that they are valid and supported. And, procedures should be formally documented for processes such as the upload of transactions from the bank to eliminate the possibility of items being uploaded or recorded on multiple occasions.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR MATERIAL WEAKNESSES

2007-03 Cash and Investments (Continued)

While we understand that Finance staff has subsequently developed procedures to improve the bank reconciliation process, the annual audit should not be the only time that these problems are identified and made a high priority. Any time bank reconciliations fall behind, sufficient staff resources must be made available until the reconciliations are brought current. The cause of delays in the reconciliation processes must be corrected to prevent more errors from occurring.

B. Investment Reconciliations

Similar to bank account reconciliations, the investment account balances must be reconciled with the general ledger. To facilitate this reconciliation, the Investment Portfolio Report should be prepared from investment statements, and a reconciliation of the Investment Portfolio Report should be made to the general ledger. Finance staff does not reconcile the Investment Portfolio Report to the general ledger which has resulted in a number of reporting errors as discussed below. Any differences noted during the reconciliation process should be researched, resolved, posted and documented.

We reviewed the March 31, 2007 Investment Portfolio Report and noted a number of deficiencies with the Report. Although these issues had been corrected as of the June 30, 2007 Investment Portfolio Report, there were other errors at June 30, 2007 discussed in item #2007-04 below. With a reconciliation of the Investment Portfolio Report to the General Ledger, the errors discussed here and in item #2007-04 below may have been discovered by City staff, rather than by the auditors. The issues as of March 31, 2007 were as follows:

Omitted Investments

During our review of the Greater Bay Bank Statements folder, we noted two Certificates of Deposit totaling \$5,011,574 that were not included on the Treasurer Report. All of the City's investments should be included in the Treasurer's Report.

Incorrect Investment Titles Reported

The Investment Portfolio Report included three investments that were improperly labeled. A Federal Agency investment was labeled as a "Treasury Security-Coupon", and two Money Market Investments (Alta Alliance and CalTrust) were labeled as "Cash in Banks". These investments should have been reported in the appropriate sections in the Treasurer's Report

Incorrect Investment Issuer Reported

A money market investment is listed as Greater Bay Bank. However, the bank statement supporting the balance is from Mt. Diablo National Bank. We understand Mt. Diablo National Bank is a subsidiary of Greater Bay Bank. Investments should be listed according to the name of the institution on the statement, not the parent company.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR MATERIAL WEAKNESSES

2007-03 Cash and Investments (Continued)

Incorrect Values Reported

The market values reported for the Alta Alliance Bank and Cal Trust investments did not agree with the investment statements. The statement balances at March 31 totaled \$10,153,053 but the market value was reported as \$10,192,618.

The balance reported for the Harbor Navigation Improvement Bonds did not agree with the Trustee statements. The statement balances at March 31 totaled \$327,883, but the balance reported was \$321,404.

All investment and trustee statement balances should agree to the Investment Portfolio Report amount and should be reviewed for accuracy. Although not significant differences, they could indicate that journal entries had not been recorded or had been recorded in error.

Escrow Accounts

The Escrow Accounts for the Country Club Vista Assessment District totaling \$11,680,114, Harbor 1996 totaling \$2,277 and the Harbor 1991 Tax Allocation Revenue Bonds totaling \$1,783,784 were included on the Treasurer's Report. The escrow accounts are related to the refunding of prior bonds and are no longer under the control of the City therefore these accounts should not have been included on the Treasurer's Report.

C. Compliance with the City's Investment Policy

As with any of the City's policies, Finance staff should ensure that transactions and reporting are made in compliance with the current Investment Policy. We reviewed the City's compliance with the FY2006-2007 and 2007-2008 Investment Policy Statement and noted the following:

Interest Allocation

The Interest Earnings Section of the Policy requires that "all moneys earned and collected from investments authorized in the Investment Policy shall be allocated monthly." During fiscal year 2006-2007 the City allocated interest earnings on a quarterly basis. Finance staff should either make the allocation on a monthly basis to comply with the Policy, or revise the Policy to reflect current practices.

In addition, since the bank and investment reconciliations above were not completed timely, the Finance staff had to review journal entries that result from the completion of those reconciliations to ensure that the transactions did not take place in a period that would have resulted in a misallocation of the interest among the funds.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR MATERIAL WEAKNESSES

2007-03 Cash and Investments (Continued)

Broker/Dealer Monitoring

The Banks and Securities Dealers Section of the Policy states that "the Treasurer shall continue to monitor financial institutions' credit characteristics and financial history throughout the period invested." We understand that Finance staff sends out a questionnaire to the dealers prior to initiating any transaction with a dealer, but that subsequent monitoring activities have not been performed. Finance staff should continue to monitor financial institutions throughout the period invested in order to comply with the Investment Policy.

In addition, we compared the current Authorized Broker Dealers List with the Investment Binder and found that the City had purchased its investments through 10 dealers, however, there were only 7 dealers on the Authorized Dealers List. Finance staff indicated that they had performed "authorization procedures" for the 3 dealers, but did not retain records of the procedures performed. Finance staff should keep a record of procedures performed to authorize dealers and update its Authorized Broker Dealers List timely to make sure all the City's investments are handled by qualified dealers.

Current Status:

- A. Implemented
- B. Implemented
- C. Implemented

2007-04 Long Term Debt Transactions and Accounting

The City has more than 21 debt issues for which interest and principal transactions take place throughout the year. In addition, the City had new debt or leases issued during the fiscal year that needed to be recorded. During the year-end audit, we proposed seventeen adjusting journal entries related to debt transactions. While staff prepared a number of the above journal entries during the audit, we found corrections were needed to those entries which we provided to staff. During our testing of long-term debt transactions we noted the following:

Wastewater Bonds

The City issued Series 2006A and 2006B Wastewater Revenue Refunding Bonds in October 2006 in the principal amount of \$48,830,000. In addition to providing additional project funding, the 2006 Bonds refunded the 1999 Wastewater Revenue Refunding Bonds. As of January 2008 the City had not removed the 1999 Bonds from the general ledger and had recorded only a few minor transactions related to the 2006 Bonds. In addition, the fiscal agent transactions from October 2006 to June 30, 2007 had not been recorded in the general ledger including project drawdowns and the associated capital assets totaling \$9,318,897, debt service payments totaling \$545,179, interest rate swap receipts of \$689,876, and interest earnings of \$1,203,259. When the City issues debt it must record the new debt and remove refunded debt issues from the general ledger in a timely manner.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR MATERIAL WEAKNESSES

2007-04 Long Term Debt Transactions and Accounting (Continued)

AWC Debt Payments

The Auto Warehousing Company (AWC) makes monthly payments via wire transfer directly to the City's Trustee account to fund its semi-annual debt service payments on an associated loan. The Finance Department reconciles the debt service payments and revenue using the trustee statements, but the Port accounting personnel reconcile the information based on statements received from AWC. Excess funds in the Trustee account after the debt service payments are made are supposed to be applied directly to the outstanding principal balance. Port accounting personnel indicated that AWC's records do not agree with the Finance Department's records. During the year-end audit, we found that payments from AWC totaling \$3,348,787 had not been recorded as a reduction to the principal balance of the lease. In the future, the Finance Department and the Port accounting personnel should work together to reconcile the outstanding balance of the loan and ensure that the monthly and semi-annual payments are applied correctly and consistently.

Unrecorded Capital Lease and Delinquent Payments

During our testing of the June 30, 2007 Investment Portfolio Report we noted that the cash balance related to a new capital lease in the amount of \$2,660,000 was reported on the Report, but not in the general ledger. And, the lease payable had been recorded in the Long-Term Debt Account Group but should have been recorded in the Information Technology Internal Service Fund.

The lease was executed early in fiscal year 2007, and we understand that capital items have been purchased that could have and should have been funded through drawdowns from the capital lease, but they were not. We understand that City staff had not tracked the equipment to be purchased with this lease and therefore no reimbursement drawdowns had been requested from the escrow agent.

Finally, the City did not make the debt service payment due on June 15, 2007 until July when the City received a "Past Due" invoice which also assessed a late payment penalty of \$15,000.

City staff should develop procedures to ensure that all debt transactions are recorded timely in the general ledger and all debt service payments are made timely to avoid penalties. In addition, debt proceed accounts should be reviewed periodically to ensure that if the equipment or other items to be funded by the proceeds have been purchased, drawdowns are completed timely.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR MATERIAL WEAKNESSES

2007-04 Long Term Debt Transactions and Accounting (Continued)

Unrecorded Debt Service Transactions

During our testing of principal and interest payments due for fiscal year 2007 we found the following:

- 1996 Port Revenue Bonds and 1999 Port Revenue Bonds interest income earned on funds held by the fiscal agent of \$12,245 and \$64,817, respectively, used to reduce the debt service payment from the City had not been recorded in the general ledger.
- State Revolving Fund Loan Contract Municipal Sewer Enterprise Fund debt service principal payments of \$375,358 had been recorded as an expense in the general ledger rather than a reduction of the debt balance.
- 2005 Pension Obligation Bonds capitalized interest accretion of \$5,770,538 had not been recorded in the general ledger.
- Interest payable at June 30, 2007 had not been adjusted in the Enterprise Funds – the balances still reported the June 30, 2006 balances. The necessary adjustments resulted a reduction of \$235,124.
- The Lease and Deferred Revenue balances in the Joint Powers Financing Authority Debt Service Fund had not been adjusted to reflect current year activity that netted to \$1,693,275.
- Transfers from the General Fund to fund debt service payments in the General Debt Service Fund totaling \$575,957 were recorded twice.

All debt service transactions should be recorded timely. Simple analyses of fund account balances and activity should have revealed these adjustments.

Uncleared or Unposted Cash with Fiscal Agent

The restricted cash balance of \$28,184 in the Equipment Services and Replacement Internal Service Fund was unchanged from June 30, 2006 to June 30, 2007. The balance was related to a capital lease account that is no longer active, but the City had not requested a drawdown from the escrow agent. In addition, interest earned in the account had not been recorded in the general ledger.

Although the activity for the debt service accounts for the Country Club Vista Assessment District has been minimal for the last two fiscal years, the activity totaling \$16,003 had not been recorded in the general ledger. Fiscal agent account activity should be recorded in the general ledger with the receipt of each fiscal agent statement.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR MATERIAL WEAKNESSES

2007-04 Long Term Debt Transactions and Accounting (Continued)

Wastewater Operations and Non-Bond-Related Projects Charged to Bond Proceeds

As we'd noted during the 2006 audit, our Agreed Upon Procedures Report for the City's 1999 Wastewater Revenue Bonds and the 2001A JPFA Lease Revenue Bonds resulted in the finding that wastewater operations costs and "non-bond projects," net of additional Bond-eligible costs found that were not charged to the Bonds, totaling \$2.4 million had been charged to the 1999 Wastewater Revenue Bonds, and "non-Bond projects" totaling \$1.7 million had been charged to the 2001A JPFA Lease Revenue Bonds. These costs have not yet been refunded to the fiscal agent accounts, even though the 1999 Bonds were refunded by the 2006 Wastewater Revenue Refunding Bonds. The City should either refund the ineligible costs to the fiscal agent accounts, or determine whether capital costs to be included on the next reimbursement request could be reduced to reflect the repayment of the ineligible costs.

As noted above, all debt service transactions should be recorded timely. Simple analyses of fund account balances and activity should have revealed these missing adjustments. Without making these corrections during the fiscal year, interim financial reports are inaccurate.

Current Status:

Implemented, however see 2008-02

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**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2007-05 Financial Statement Budget Information

We requested a report of general ledger original and final budget amounts in November 2007 to be incorporated into the Comprehensive Annual Financial Report. The data was not provided to us until February 2008, and that data required adjustment. The City should be able to produce financial data to prepare financial statements at any point during the year. The City should ensure that the new general ledger system is structured to easily produce financial statement data and with budgetary comparisons.

Current Status:

Implemented, however see 2008-01

2007-06 Access to the General Ledger Accounting System

During our review of access to the City's general ledger accounting system, we attempted to obtain an access log by employee to ensure that the access to the system was appropriate with the respect to employee job duties. Due to the complexities of the City's system, the City was not able to produce an all-encompassing log. . The City should be able to generate a log to easily monitor employee's access to various modules to ensure the access is authorized and appropriate.

Current Status:

Implemented

2007-07 Access to General Ledger Adjustments

The City's accounting system has two steps to control the input and approval of journal entries. First, the journal entry must be "parked" in the system, which means the entry must be created and entered into the system by a preparer. Next, the entry is "posted" to the system to change the general ledger balances. The City's process is to keep these two functions segregated. Employees are able to perform one function or the other, but not both, which provides good internal controls.

During the final phase of the audit, we reviewed certain access reports and noted that an Accountant II, Accounting Assistant II, and the Chief Accountant are all allowed to perform both functions. We understand that the Accountant II's ability to perform both of these functions was assigned temporarily due to a one-time project and the "post" ability has already been reversed. The other two positions had access to both functions and were not reversed. With the number of employees that the City has that can park or post transactions, the need to allow both of these functions to one employee does not appear necessary at any time. The City should restrict the access of all employees to only performing one of the steps.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2007-07 Access to General Ledger Adjustments (Continued)

In addition, we found that five ex-employees are still listed on the system access report and are able to “park” in the system. We understand that these employees’ access to the system network can be denied by the Information Technology Department, but there is not a policy or procedure to inform the IT Department of terminated or transferred employees. The City should ensure that changes in access are monitored and reviewed to ensure that they are proper, especially when an employee’s job functions change that may cause additional conflicts. The City should also develop a procedure to ensure that access to the City’s network and general ledger system are removed from employees as soon as they are terminated or transferred.

Current Status:

Implemented

2007-08 Project Reimbursement Checks

After we inquired about whether the City had received funding from the Metropolitan Transportation Commission (MTC) for any capital projects during the fiscal year, we were presented with two reimbursement checks that had not be deposited into the City’s bank account and had not been recorded in the general ledger. Both were final payments for an MTC-funded project that occurred during fiscal year 2007. The first check from MTC was dated August 1, 2007 in the amount of \$93,600, and the second check was from the Bay Area Air Quality Management District dated August 16, 2007 in the amount of \$100,000. We understand that City staff was unclear about what account string to use for these two checks. These checks were not deposited in the City’s bank account until January 2008.

The City should consider requiring all remittances from reimbursement requests and other claims to be sent to one location in the City, such as the Finance Department. While individual departments may prepare reimbursement requests, they do not need to receive the remittances. And City staff should be informed that all checks are to be deposited immediately upon receipt. In the event the initial coding of a receipt is unclear, it should be posted to a clearing account in the general ledger until the correct coding can be determined.

Current Status:

Implemented

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2007-09 Housing Authority Receivable

As of June 30, 2006 the Housing Authority Enterprise Fund owed the General Fund and various other funds \$3,592,963. During fiscal year 2007 the City and the Housing Authority reached an agreement regarding the balance owed and it was reduced by \$748,912. The write-down of the receivable was not recorded in the general ledger as of June 30, 2007. Transactions should be recorded in the general ledger as they occur.

In addition, during our review of accounts receivable we noted an additional balance of \$51,536 in the general ledger owed to the City by the Housing Authority was dated to prior to fiscal year 2006. This balance was miscoded to the wrong general ledger account and therefore was not included in the settlement/repayment agreement with the Housing Authority. Therefore, this balance did not appear collectible and was written off as of June 30, 2007. Again, account analyses and reconciliations to supporting documentation should have revealed this coding error.

Current Status:

Implemented

2007-10 Claims Payable Adjustments

During the year-end closing, City staff adjusted the balance of uninsured claims payable to agree with the current actuary report. As a separate entry, City staff recorded an estimated balance for the portion of claims payable that are expected to be paid over the next fiscal year. This current portion of claims payable should have been reclassified from the long-term balance of claims payable, rather than adding to the total liability balance. As a result, the balance of claims payable was overstated by \$9,560,000. This error should have been discovered during the journal entry review process.

Current Status:

Implemented

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2007-11 Capital Assets Accounting and Transactions

During our testing of capital asset additions and comparing additions to capital outlay, we noted the following:

- A. A project shared by the City and Redevelopment Agency was capitalized by both agencies in the amount of \$500,000.
- B. The City Hall project with costs totaling \$10,012,115 was not recorded as Construction in Progress.
- C. Municipal Sewer project costs totaling \$9,318,897 paid by the fiscal agent from bond proceeds had not been recorded or capitalized, as discussed above in item #2007-04.
- D. Project expenditures funded by the Gas Tax Special Revenue Fund (\$1,994,107) and the Measure C Capital Projects Fund (\$2,116,839) originally recorded in the General Capital Projects Fund were reclassified in the general ledger. When capital outlay expenditures were being analyzed by City staff for capitalization, they were reclassified to capital outlay in the General Capital Projects Fund. However, the expenditures had already been moved to the Gas Tax and Measure C Funds. As a result, the General Capital Projects Fund reported negative expenditures.
- E. An amount recorded as Construction in Progress (\$999,850) was found to be a loan to a developer for the Easter Hill Project and loan expenditures for the fiscal year totaled \$2,281,960. The loan receivable had not been recorded in the general ledger.

During the year end close, City and Redevelopment Agency staff should review all capital outlay expenditures in detail to determine whether items represent assets such as loans or projects that should be capitalized. And co-funded projects should be analyzed to ensure that duplicate entries are not recorded.

Current Status:

- A. Implemented
- B. & C. Implemented
- D. Ongoing
- E. In Process

2007-12 Paratransit Operations Special Revenue Fund Revenue Budget

During our review of the draft financial statements, we asked why the Paratransit Operations Special Revenue Fund's budgeted intergovernmental revenue were \$1,132,433, while actual revenues were only \$484,171. Based on a review of the City's prior year financial statements, the Paratransit Fund has received approximately \$480 thousand per year since fiscal year 2005. We understand from our discussion with City staff that additional intergovernmental grant revenue was not expected, and the budget amount of \$1.1 million appeared to be overstated. During the budgeting process, City staff should take more care to ensure that more realistic revenue budgets are adopted. If a fund's revenues are overstated, expenditures may be budgeted based on that inaccurate information and may exceed the actual funding sources. In fact the Paratransit Fund's actual expenditures exceeded its revenue by \$233,601, and the Fund ended the fiscal year with a deficit fund balance of \$228,453.

Current Status:

Implemented

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2007-13 Business License Accounts Receivable

We were provided an Accounts Receivable Summary Schedule and Aging Analysis for the general accounts receivable and noted a credit balance of \$1,017,546 for a line item labeled "Deposits, Licenses and Permits - Business License". We inquired about the source of this balance and understand that it is compiled from two separate databases that include both Planning and Business Licenses. However, we understand that information is not available for City staff to determine whether the balances are related Planning or Business Licenses and that City staff did not reconcile this data to supporting documentation. We understand that a portion of the balance may be related to business license billings that have been paid but not applied to the corresponding receivable. City staff should determine the composition of this balance and reconcile the balance on a regular basis to ensure accurate reporting of receivable balances.

Current Status:

Implemented

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CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
STATUS OF PRIOR YEAR OTHER MATTERS

2007-14 Employee Receivables

Accounts receivable from current and former City employees totaled \$158,222 at June 30, 2007. During our review of the individual balances, we noted the following:

- A. One employee owed the City \$43,097. This receivable has been outstanding for over a year and no payments were made to the City during the fiscal year. According to City staff, this matter has been turned over to an attorney.
- B. Another employee owed the City \$11,228. According to City staff, the City is attempting to work out a payment plan, however this amount has also been outstanding for at least a year with no payments from the employee.
- C. There are 11 retired employees with outstanding balances totaling approximately \$10,400 for which no payments had been made during the fiscal year.
- D. Two employee receivables from excess reimbursements that occurred in December 2006 totaling \$21,320 had not been recorded as a receivable prior to the start of the year-end audit.

The City should ensure that payment plans are established with employees as soon as overpayments are discovered. Once an employee leaves the City, the likelihood of timely collection is reduced, because the payment cannot be incorporated as a payroll deduction.

Current Status:

Implemented

2007-15 Procurement Card Transactions

During the interim phase of the audit we selected 48 Procurement Card (CalCard) transactions of 11 employees for testing of compliance with City policies. We noted the following regarding some of the purchases made by the Operations and Maintenance Division of the Public Works Department:

- a. The City's Procurement Policies and Procedures Manual states that CAL-Cards are for "official business only", however during our testing, we noted several purchases made by the Operations Administrator that appeared to be personal items. The Operations Administrator purchased a National Association for Female Executive Members Directory for approximately \$115. In speaking with the employee she stated that the Directory was necessary due to her being an executive and being female. Our understanding is that these directories are usually used for marketing and networking purposes, and we question if this is related to "official business" of the City.
- b. Due to our questions regarding this purchase, we selected 5 additional purchases from this employee's transactions for testing. The additional transactions tested included the payment of a late cancellation fee of \$495 for the Ritz Carlton Hotel for a National Association for Female Executives conference, and the purchase of an eight foot wall mural of the Virgin Islands for \$750. The employee stated that she could not attend the conference due to having to work and that she purchased the wall mural because she "liked water".

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR OTHER MATTERS

2007-15 Procurement Card Transactions (Continued)

The conference cancellation was made too late, so the hotel fee had to be paid. Approval of this payment should have been more clearly documented, because the description in the general ledger said that the payment was for the actual conference. The mural was installed in the employee's office. This mural does not appear to be for "official business only".

- c. In addition, we noted that the bankcard statement detailing the purchases in "a." above included an Approving Official signature that was a rubber stamp, not a real signature. Bank statements should be reviewed by Approving Officials and signed in pen instead of just stamped with a rubber stamp. Rubber stamps should be restricted to use for unofficial documents, such as memos, and prohibited from use for approving transactions.
- d. In reviewing the Operations Administrator's bankcard statement we noted that she was also her own Approving Official. We understand from the Purchasing Department that this is only a problem at the bank and that she could not authorize her own purchases at the City. However, the bank information needs to be updated with the correct Approving Official.
- e. The CAL-Card transaction Receipt Report lists the City Manager as the Approving Official for the Operations Administrator's CAL-Card purchases. During our testing, we noted that the Approving Official signing off on the Bankcard Statements was the Operations and Maintenance Division's Director. Bankcard Statements should not be approved by anyone other than the predetermined Approving Official.

During the final phase of the audit, we selected 18 additional transactions of six Public Works Department employees for testing of compliance with the City's policies and noted the following:

- f. Three Purchasing Card Cardholder Activity Statements were approved by the wrong Approving Official. The Approving Official should have been the Operations Administrator, but the Statements were approved by the Office Assistant II. Only the authorized Approving Officials should be signing the statements in order to prevent unauthorized purchases and ensure compliance with the City's policies.
- g. One employee exceeded his 30 day monthly spending limit. The employee's spending limit was \$30,000, however during the period May 23, 2007 to June 22, 2007 the employee spent a total of \$30,219. This was also one of the monthly Purchasing Card Cardholder Activity Statements that was approved by the Office Assistant II. Monthly spending limits should be enforced, and in the event they are to be exceeded, prior approval should be required and documented.

During our testing, we also noted that when an employee no longer needs a CAL-Card, the card is deactivated and the transaction limit is reduced to \$1. We understand that this is the practice in the event an employee is to be reissued a card, the Purchasing Department would not have to re-enter the employee's complete information. The City should consider canceling the card after an employee's card has been deactivated. Not cancelling the card could create an opportunity for the cards to be used fraudulently.

Current Status:

Implemented

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR OTHER MATTERS

2007-16 Port of Richmond Accounting

We reviewed the cash collection and accounts receivable procedures at the Port of Richmond and noted the following:

A. *Standardization of Cash Collection Procedures*

Cash receipts for the Port are received by both the Port accounting personnel and by the City's Finance Department. There is no standard procedure for which location should be the primary one for receiving the cash receipts. If the Port receives the checks first, they make copies for their records, match the check to the invoice, and documents the account number that it should be credited to prior to sending the checks to the Finance Department for posting to the general ledger system and deposit in the bank. If the Finance Department receives the checks first, the receipts are entered into the system and deposited with the bank. However, we understand that the Finance Department does not forward the information to the Port to ensure that they are matched with the correct invoice and coded correctly.

Port accounting personnel indicate that they cannot verify the accuracy of the accounts receivable balance by customer due to inconsistent or incorrect account coding. In addition, Port accounting personnel have indicated that some customer payments by wire transfer had not been applied to the correct Port receivable account.

Port accounting personnel and Finance Department personnel should develop a standard procedure for handling the Port receipts including wire transfers. All Port-related receipts should be received directly by the Finance Department and coding of the receipts should either be initiated or approved by Port accounting personnel.

B. *Standardization of Accrual Methods*

The timing of Port invoices can lead to unbilled receivables for the Port at June 30 due to the time it takes from when a ship comes in to when a ship's manifest arrives at the Port's offices. Ships can come into a terminal in June and the Port office may not receive the manifest for that ship until July or even later. Invoices are not prepared until the manifest arrives at the Port's office, therefore even though the invoice is sent in July the revenue should be accrued to the previous fiscal year. The Port currently accrues some receivables back to June 30, but does not do so for all invoices since some manifests arrive as late as August. Port accounting personnel should develop a standard accrual procedure, such as accruing all invoices for manifests received in July and August, even if the related invoice is not sent until September. Although we did not find that any adjustments to the accruals were necessary at June 30, 2007, setting a firm cutoff date would help ensure that accounting for receivables and revenues is consistent from year to year.

Current Status:

Implemented

CITY OF RICHMOND
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STATUS OF PRIOR YEAR OTHER MATTERS

2007-17 Encumbrances and Purchase Orders

We selected ten encumbrances for testing of supporting purchase order documentation and noted the following:

- One encumbrance in the amount of \$1,545,360 was not supported by an executed purchase order. The encumbrance had been established for the planned purchase of police radios that had not been approved by Council as of June 30, 2007. Council subsequently approved the purchase, but for a total amount of only \$473,359.
- One encumbrance in the amount of \$475,959 was not supported by an executed purchase order. The encumbrance had been established for a planned project that had not been approved by Council as of June 30, 2007. The Council had still not approved the project as of February 2008.

We were told that the initial purchase orders were established to encumber funds at the end of the fiscal year for projects initiated prior to the fiscal year end that are expected to be approved shortly after year end. At fiscal year end, we understand that the Purchasing Department often uses "held" purchase order placeholders for prior fiscal year monies to allow for the completion of the competitive bid processes that were already started and to allow the monies to be rolled into the next fiscal year.

The establishment of year-end purchase orders and the roll-over of purchase orders should be adequately supported by valid obligations of the City, such as an outstanding contract or other commitment to purchase the services or supplies.

Current Status:

Implemented

2007-18 Investment Testing

We selected a total of 6 new and matured investments from the March 31, 2007 Treasurer Report and a total of 7 new and matured investments from the City's individual broker/dealers files. Finance staff was unable to locate the file of supporting documentation for the approval of one of the tested investments, a Federal Home Loan Mortgage Corporation medium term note purchased August 10, 2006. Although the investment was included on the City's safekeeping statement and appeared to be in compliance with the City's investment policy, we were unable to review for evidence of the proper City staff authorization for the purchase of this investment. Finance staff should review the investment files to ensure that they are complete.

Current Status:

Implemented

CITY OF RICHMOND
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2007-19 Government Code Section 53646 - Reporting

California Government Code section 53646(b) requires that the City submit a quarterly report to the City Council within 30 days following the end of the quarter covered by the report. When the City elects to prepare monthly reports to Council, the Government Code still maintains the 30 day filing period. The City's March 31, 2007 report was submitted to the Council on May 31, 2007, and the June 30, 2007 report was submitted to the Council on October 2, 2007, which exceeded the 30 day requirement. The City should submit its reports in a timely manner to comply with the California Government Code.

Current Status:

Implemented

2007-20 Loan Documentation Execution

During the interim phase of the audit, we selected eight new loans and six loan payoffs for testing of appropriate supporting documentation and approval and noted the following:

- Five of the loans tested (two new loans and three loan payoffs) did not contain an approval signature for the loan.
- One of the new loans tested was between the City and the City's Police Activities League, but the supporting loan documents were not fully executed and did not use the correct support as follows:
 - The Promissory Note was not dated and not signed by the borrower.
 - The Deed of Trust was signed on February 6, 2007, but was not recorded with the County.
 - The loan referred to land collateralizing the loan agreement, but there appeared to be no such land.
 - In addition, the Promissory Note indicated that loan repayments were to begin on March 6, 2007 but no payments had been made as of July 31, 2007.

Upon further discussions with Finance staff, we understand that the loan agreement should have been in the format of an interfund or inter-agency loan, since the Police Activities League is part of the Police Department.

City staff subsequently amended the loan agreement with the Police Activities League to reflect the correct arrangement. However, future loan agreements should be reviewed prior to execution to ensure that they correct format and security documents are utilized. In addition, loan agreements should be reviewed to ensure that payments due are received timely. In the event an agreement requires a deed of trust, it should be recorded with the County. And, all loan documentation should be fully executed and maintained in the loan files.

Current Status:

Implemented

**CITY OF RICHMOND
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STATUS OF PRIOR YEAR OTHER MATTERS

2007-21 Receipt Documentation

We tested 43 subsequent receipts from July 1, 2007 through November 21, 2007 to determine whether they were properly accrued as of June 30, 2007. Two remittance advices for the September 2007 Sales Tax Revenue and Measure Q Sales Tax Revenue from the State of California that includes the June 2007 "clean up" payments could not be located. The clean up payments had not been recorded as revenue in fiscal year 2008 and had not been accrued to fiscal year 2007, however to be consistent with the accrual procedures in the prior year they should have been accrued to 2007. Due to the missing documentation we were unable to determine the exact amount of the clean up payments. With City staff we were able to estimate the amount of the clean up payments and record an adjusting journal entry to accrue the revenue as of June 30, 2007. However, City staff should ensure that supporting documentation for receipts is retained in the appropriate files.

Current Status:

In Process

2007-22 Clearing Accounts Receivable to the Correct Funds

The Storm Sewer Enterprise Fund reported a negative accounts receivable balance of \$25,747 at June 30, 2007. We understand that the negative balance was caused by a partial payment incorrectly posted in the Accounts Receivable System that needs to be corrected through an Accounts Receivable billing, rather than a journal entry. The appropriate billings/corrections should be made more timely. City staff should be analyzing general ledger balances by Fund, not just in total, which would reveal the errors and the need for adjustments.

Current Status:

Implemented

2007-23 Accounts Payable/Purchasing Procedures

Chapter 4 of the City's Procurement Policies and Procedures Manual requires that sealed bids be used for all materials and equipment costing \$25,000 or more. We selected 40 disbursements for testing and one disbursement in the amount of \$41,808 for the purchase of an asphalt melter and materials was supported by only informal unsealed bids. The City should follow the processes of the Procurement Policies and Procedures Manual or revise the policies to conform with current practices.

Current Status:

Implemented

**CITY OF RICHMOND
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STATUS OF PRIOR YEAR OTHER MATTERS

2007-24 Accounts Payable – Late Payments

We tested 38 subsequent disbursements from July 1, 2007 through November 15, 2007 to determine whether they were properly accrued as of June 30. During those tests, we did not note any material items that had not been properly accrued, however we did note the following:

- Two disbursements to Pacific Gas & Electric Co (PG&E) were paid on the same day (August 8, 2007):
 - The first disbursement was for invoices that had service dates ranging from March 14, 2007 to May 29, 2007. The dates stamped on each of the invoices showed that they were received by the Public Works Department from May 11, 2007 to June 11, 2007. The due dates on the individual invoices from PG&E were from May 24, 2007 to June 15, 2007.
 - The second disbursement was for invoices with dates ranging from February 22, 2007 through June 26, 2007. The dates stamped on each of the invoices showed they were received by the Public Works Department from June 11, 2007 to July 23, 2007. The due dates on the individual invoices from PG&E ranged from June 25, 2007 to July 16, 2007.
- One disbursement to Environmental Science Associates service dates were from February 1, 2007 to April 30, 2007 was not paid until August 15, 2007.

The City should review the process for paying invoices to ensure they are paid timely and, in the case of utility bills, to ensure additional fees are not incurred. In the event there is a valid reason for the delayed payment, City staff should document why an invoice may have been paid late.

Current Status:

Implemented

2007-25 Deposits Payable

We selected twenty-five deposits from the deposits payable detail for testing and noted the following:

- Asset seizure money in the amount of \$10,073 was recorded as a deposit payable. In April 2007 a portion of this deposit in the amount of \$4,474 was distributed to the Contra Costa County District Attorney's office, but the deposit payable was not reduced for the payment.
- Two project retentions payable from fiscal year 2005 in the amounts of \$21,309 and \$175,614 were recorded as deposits payable. In addition to the fact that they were not truly deposits payable, these balances had been previously released and paid to the vendors.
- Supporting documentation could not be located for one deposit for rent security in the amount of \$200 which was received July 30, 2004.

Also, during our testing, we reviewed the deposits payable detailed schedules provided by City staff. Many of the outstanding deposits listed have been outstanding for more than one year. Although some deposits, such as asset seizure funds, may be outstanding for a considerable time, other deposits do not have an identified depositor and City staff are unsure whether they are still a valid deposit payable.

City staff should review all outstanding deposits payable to ensure that proper supporting documentation exists and that they are still valid deposits.

Current Status:

Implemented

**CITY OF RICHMOND
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STATUS OF PRIOR YEAR OTHER MATTERS

2007-26 Community Development Block Grant Program Cash Management

We selected 24 Community Development Block Grant program expenditures for testing of compliance with program guidelines and tracing to reimbursement requests/drawdowns. We found that three disbursements totaling \$34,238 were for services performed in fiscal year 2007, but they have not yet been included in reimbursement requests/drawdowns to date. The City should establish procedures to ensure that all applicable program expenditures are included in grant reimbursements/drawdowns on a timely basis.

Current Status:

Implemented

2007-27 Outstanding Checks

As a part of our testing of bank reconciliations, we reviewed the outstanding check listings as of June 30, 2007. The outstanding check listing for the accounts payable account included checks that have been outstanding from 1 to 7 years totaling approximately \$619 thousand. The outstanding check listing for the payroll checking account also included checks that were outstanding from 1 to 6 years totaling approximately \$374 thousand. The City should investigate these old outstanding checks to determine if they were re-issued, or if they could be written off. The City should adopt a policy for handling checks outstanding for a long period of time.

Current Status:

In Process

2007-28 Signature Cards and Authorized Personnel

The authorized persons for two of the City's Local Agency Investment Fund accounts (Redevelopment Agency and Richmond Pension Fund) were not updated for changes in City personnel. Two former employees, including the former Acting Finance Director, were listed as authorized personnel on these two accounts.

When authorized signers leave the City, their name should be removed from the signature cards immediately. We made this comment in the prior year, but the authorizations have not yet been updated.

Current Status:

Implemented

CITY OF RICHMOND
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2007-29 Advance Between the Redevelopment Agency and the General Fund

The balance of interest on advances of \$3,621,711 related to an advance from May 1991 between the Redevelopment Agency and the General Fund remains unchanged since fiscal year 2005. We understand this is because the principal on the loan amount has already been repaid and the accrued interest is a remaining balance from the prior fiscal year. Finance staff should investigate the account to determine whether the balance should be repaid or whether authorization for its forgiveness should be obtained.

Current Status:

Implemented

2007-30 Storm Sewer Advance

During fiscal year 2007 the advance of \$481 thousand between the Storm Sewer Enterprise Fund to the Municipal Sewer Enterprise Fund was moved to the General Fund. After we inquired about the change, City staff proposed to move the advance back to the Municipal Sewer Fund, and then found that the Storm Sewer Enterprise Fund had sufficient cash to repay the advance and therefore proposed to repay the balance. The original movement of the advance to the General Fund should not have been made by City staff since the interfund advance had not been forgiven. City staff should ensure that all adjustments of balances such as advances are reviewed in detail and supporting documentation is valid and approved.

Current Status:

Implemented

2007-31 Payroll Personnel Action Forms

We selected 40 employees from the May 1, 2007 pay date for payroll testing and noted that one employee's Personnel Action Form (PAF) did not include her bilingual pay. We understand that once bilingual pay is established and in the system, it is not repeated on future Personnel Action Forms. However, this situation is similar to the one we found during the June 30, 2005 audit – flat-rate pay adjustments added to employees pay are not included on future PAFs after they are established in the payroll system. Employee pay information should be current on each PAF, including all special pay types to reduce confusion as to how much an employee should be earning.

Current Status:

Implemented

CITY OF RICHMOND
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2007-32 Negative Interest Allocations

The City's interest income allocation includes charging funds that carry negative cash balances. However, during that process Finance staff needs to look at the cause of the negative cash balance. For example, one general ledger fund had a negative pooled cash balance of approximately \$70 thousand due to a misposted journal entry but the negative cash continued to increase due to the interest allocation charge. Finance staff should review periodically review all negative cash balances prior to the interest allocation to ensure that they are not the result of a misposted entry.

Current Status:

Implemented

2007-33 Insurance Reserves Internal Service Fund Charges for Services

Charges for services to the funds serviced by the Insurance Reserves Internal Service Fund declined \$1.7 million during fiscal year 2007, while charges for services increased in the City's four other Internal Service Funds. However, the Insurance Reserves Fund has deficit net assets of \$9,703,160 at June 30, 2007. The City should analyze the funding for this fund to ensure that it includes eliminating the fund deficit.

Current Status:

Implemented

2007-34 Reduce Volume of Interfund Transfers

City staff provided us with a schedule and the detail for the City's interfund transfers. During our review we noted an excessive amount of transfers made between the City's general ledger funds. The gross amount for all transfers made was approximately \$84.5 million. In the detail there was a transfer for as little as \$0.50. The City should consider analyzing the cause/purpose of these transfers to see if the need for them could be reduced or eliminated in the future which would increase efficiency. This volume of transfers makes it difficult for City staff to analyze the transactions.

Current Status:

In Process

CITY OF RICHMOND
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STATUS OF PRIOR YEAR OTHER MATTERS

2007-35 Background Checks

We understand that background checks are performed only for public safety personnel. The City should consider performing basic background checks for Finance/Accounting and Recreation personnel prior to hiring, such as through the LiveScan system. We have another City client that failed to do so and found out later that an employee had a conviction that prohibited the employee from being involved with the handling of cash transactions.

Current Status:

Implemented

2007-36 GASB Statement No. 48 - Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues (effective for Fiscal Year 2007-2008)

This Statement establishes financial reporting of several categories of transactions. We have ordered the topics to those we believe are most relevant to cities, followed by the other topics:

Issues Most Relevant to Cities:

- *Intra-Entity Transfers of Assets @ Carrying Value:* This Statement stipulates that governments should *not* revalue assets that are transferred between financial reporting entity components. Therefore, any assets (or future revenues) sold or donated within the same financial reporting entity should continue to be reported at their current carrying value when those assets or future revenues are transferred. Differences between the sales price and carrying value are recognized as a gain/ (loss) on the seller's statements and as an expense/ (revenue) on the buyer's statements. A transfer or subsidy treatment should be used in the basic financial statements.
- *Disclosures of Revenue Pledged for Repayment of Debt:* Though this GASB does not appear to impact the recording of debt with pledged revenues, it will expand disclosure requirements. We have italicized what we believe to be the *change* from current disclosures as follows:
 1. Identification of the specific revenue pledged and *the approximate amount of the pledge* [e.g. remaining debt service].
 2. Identification of, and general purpose for, the debt secured by the pledged revenue.
 3. The *term of the commitment* [e.g. remaining term of the debt].
 4. *The relationship of the pledged amount to the total for that specific revenue*, if estimable—that is, the proportion of the specific revenue stream that has been pledged.
 5. *A comparison of the pledged revenues recognized during the period to the principal and interest requirements for the debt directly or indirectly collateralized by those revenues.* For this disclosure, *pledged revenues recognized during the period may be presented net of specified operating expenses, based on the provisions of the pledge agreement*; [e.g. revenue coverage calculation] however, the amounts should not be netted in the financial statements.

**CITY OF RICHMOND
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STATUS OF PRIOR YEAR OTHER MATTERS

2007-36 GASB Statement No. 48 - Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues (effective for Fiscal Year 2007-2008) (Continued)

- *Financing Authorities:* The Statement does not change the substance of accounting for revenues received by a government which are pledged for repayment of debt issued by a financing authority. The Statement requires the financing authority to recognize revenue when the pledging government is obligated to make the payments. This is essentially the counterparty perspective of recognizing debt service when due.

Other Topics:

- *Exchanges of Specific Receivables/Revenues for Cash:* Statement #48 states that "Governments sometimes exchange an interest in their expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments—generally, a single lump sum. The issue addressed is whether exchanges should be reported as a sale or as a collateralized borrowing resulting in a liability. A sale treatment is permitted only if the government relinquishes control of the exchanged receivable/revenue. Specific criteria are listed in the Statement which are used to determine whether control is retained (indicating a borrowing treatment) or relinquished (indicating a sales treatment)

Exchange examples listed include the sale of future tobacco settlement revenues and the sale of delinquent property tax liens. These types of transactions are highly unusual and infrequent. This would have been helpful for those cities which securitized the VLF receivables.

- *Residual Interests and Recourse Provisions:* This Statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions.

Current Status:

The City implemented the applicable provisions of the Statement in fiscal year 2008.

2007-37 GASB Statement No. 49 - Accounting and Financial Reporting for Pollution Remediation Obligations (Effective for Fiscal Year 2008-2009)

This Statement addresses accounting and financial reporting for pollution remediation obligations (including contamination), which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. This Statement excludes pollution prevention and landfill closure or post-closure costs. A municipality must estimate expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

- Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem.
- A government has violated a pollution prevention-related permit or license.

CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL
STATUS OF PRIOR YEAR OTHER MATTERS

2007-37 GASB Statement No. 49 - Accounting and Financial Reporting for Pollution Remediation Obligations (Effective for Fiscal Year 2008-2009) (Continued)

- A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the clean up.
- A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution.
- A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

Liabilities and expenses would be estimated using an "expected cash flows" measurement technique, which is used by environmental professionals but will be employed for the first time by governments. Statement 49 also will require governments to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements.

Pollution remediation outlays should be capitalized in the government-wide and proprietary fund statements when goods and services are acquired if acquired for any of the following circumstances:

- a. To prepare property for sale. Capitalized costs (including pollution remediation costs) continue to be limited to lower of cost or net realizable value
- b. To prepare property for use when the property was acquired with known or suspected pollution that was expected to be remediated. Governments should capitalize only those pollution remediation outlays expected to be necessary to place the asset into its intended location and condition for use.
- c. To perform pollution remediation that restores a pollution-caused decline in service utility that was recognized as an asset impairment. Governments should capitalize only those pollution remediation outlays expected to be necessary to place the asset into its intended location and condition for use.
- d. To acquire property, plant, and equipment that have a future alternative use. Outlays should be capitalized only to the extent of the estimated service utility that will exist after pollution remediation activities have ceased.

For outlays under criteria a and b, capitalization is appropriate only if the outlays take place within a reasonable period prior to the expected sale or following acquisition of the property, respectively, or are delayed, but the delay is beyond the government's control.

Current Status:

If applicable, the City will implement the provisions of the Statement in fiscal year 2009.

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**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR COMMENTS NOT YET IMPLEMENTED

FISCAL YEAR 2006 COMMENTS

REPORTABLE CONDITIONS

Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the City's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Under the Single Audit Act and Government Auditing Standards, Management is required to respond in writing to recommendations arising out of reportable conditions.

2006-01 Start Now to Prepare for the 2007 Year End Close

The City issued its 2006 Comprehensive Annual Financial Report (CAFR) in February 2007, a one-month improvement over 2005. And, the Redevelopment Agency was able to file its financial statements before December 31, 2006, in time to meet the filing deadline with the State Controller's Office. However, as we recommended in 2005, significant improvement is still needed, and the Finance Department must continue to improve the timeliness and accuracy of the closing of the books. Some of the major tasks that need accomplished include:

- A. Finance should continue to strengthen the monthly reconciliation and analyses of accounts so that errors can be discovered and corrected on a timely basis and the work required to close the books is reduced accordingly. We had 81 adjusting journal entries in the fiscal year 2005 audit, and had 81 adjusting journal entries in the fiscal year 2006 audit. Many of these entries related to transactions that should have been posted during the fiscal year and were not related to the year-end closing items.
- B. Account analysis should not be left until the audit commences. We prepare Analytical Review questions as part of the year-end audit and found that City staff responses to those questions resulted in 18 of the adjusting journal entries noted above. Finance staff should begin analyzing fluctuations, or lack of fluctuations, in significant account balances to determine that the change or lack of change is supported and any errors or corrections are incorporated prior to the year-end close.
- C. While the ultimate goal of the Finance Department should be to have no adjusting journal entries result from the audit, at a minimum the previous year's adjusting journal entries should be used as a tool to ensure that the same mistakes are not repeated. We did not find this to be the case during the fiscal year 2006 audit.
- D. Finance Department personnel need to apply the general training provided in 2005 and the specific and detailed training provided in 2006 in their particular areas. We provided general governmental accounting training in 2005; in 2006, we provided detailed training, as directed by City staff, in the areas of accounts receivable, accrued revenues, allowance for bad debts, deposits payable, purchasing controls, accounts payable processing, bond disbursements, capital assets, accounting for capital projects, bank reconciliations, interest allocations, redevelopment agency compliance, and grants management. The training classes involved interactive sessions based on specific areas of concern from the people involved with the applicable areas. However, during the audit, we found that the transactions related to many of these same areas required year-end adjusting journal entries.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR COMMENTS NOT YET IMPLEMENTED

2006-01 Start Now to Prepare for the 2007 Year End Close (Continued)

Current Status:

- A. See status of comment #2007-01
- B. Implemented by staff, however see status of comment #2007-01.
- C. Implemented by staff, however see status of comment #2007-01.
- D. In process.

2006-02 Supervision and Review

Over the past two years staff has attended training on a variety of topics covering the accounting and financial reporting as discussed above. Courses were presented in two sessions. First, an initial session was held covering the basic principles, the City's pertinent transactions and an evaluation of present practices. A second session was held which built upon the first session and included discussions of intermediate and advanced topics and concepts. These courses were designed to provide staff with the skills they need to improve accuracy and timeliness of task completion. While we have seen improvements in performance, we believe that the next step in making improvements is to strengthen the supervision and review of staff which prepare reconciliations and adjustments. We have recommendations on a variety of specific areas which we have included below that we believe are symptoms of the need for stronger supervision and review:

c. Long-Term Debt Transactions

The City has more than 25 debt issues, and interest and principal transactions take place throughout the year. In addition, the City has many lease transactions related to those debt issues, and any new debt or leases issued during the fiscal year need to be recorded in the general ledger. During the year-end audit, we had seventeen adjusting journal entries related to debt transactions. The missing transactions we noted should be recorded in the general ledger fund responsible for the debt service, and the principal addition or reduction should be recorded in the general long-term debt account group, during the month in which they occur. In addition, Finance staff need to ensure that debt service transactions that need to be recorded in the Joint Powers Financing Authority are recorded at the same time as other entries.

In addition, while staff prepared a number of the above journal entries during the audit, we found corrections to those entries that were originally proposed and provided those changes to City staff.

Current Status:

In Process. See also comment 2008-02.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR COMMENTS NOT YET IMPLEMENTED

2006-02 Supervision and Review (Continued)

f. Wastewater Operations and Non-Bond-Related Projects Charged to Bond Proceeds

Our Agreed Upon Procedures Report for the City's 1999 Wastewater Revenue Bonds and the 2001A JPFA Lease Revenue Bonds resulted in the finding that wastewater operations costs and "non-bond projects," net of additional Bond-eligible costs found that were not charged to the Bonds, totaling \$2.4 million had been charged to the 1999 Wastewater Revenue Bonds, and "non-Bond projects" totaling \$1.7 million had been charged to the 2001A JPFA Lease Revenue Bonds. We understand that these costs have not yet been refunded to the fiscal agent accounts. The City should either refund the ineligible costs to the fiscal agent account, or determine whether capital costs to be included on the next reimbursement request could be reduced to reflect the repayment of the ineligible costs.

In the future, reimbursement requests provided to the fiscal agent for drawdown of bond proceeds should be scrutinized to ensure that only applicable costs are included.

Current Status:

Implemented in fiscal year 2009.

2006-05 Assessment District Debt

The City provided us with the pre-close general ledger cash balances as of June 30, 2006. We reviewed the cash balances related to the Assessment Districts Agency Fund and compared those balances to the outstanding debt balances and noted that a number of the districts appear to have cash in excess of the District's reserve requirements, or no longer have outstanding debt balances.

At June 30, 2006, the pre-close general ledger cash account for each of the City's Assessment Districts included in the Agency Fund had the following balances:

<u>Fund Number</u>	<u>Fund Name (from General Ledger)</u>	<u>Cash Balance</u>	<u>Debt Balance</u>
3151	Cutting Canal A.D. 8	\$1,221,325	\$2,920,000
3152	Hilltop Redemption F	191,346	630,000
3154	Atlas Rd. West A.D.	389,515	0
3155	Atlas Rd. W. 853/Ph	82,638	0
7101	Hilltop Landscape Di	788,731	0
7102	Castro Street Assess	5,349	0
7103	Hilltop A-D Assess D	63,731	0
7104	Seaport District 816	54,594	0
7105	Point Richmond Parking	14,721	0
7106	Hilltop E Special Di	(6,358)	0
7107	San Pablo 854 Asses	74,152	115,000
7108	Harbor Navigation Im	517,951	1,605,000
7110	Marina Westshore Debt	782,248	4,070,000
7111	Country Club Vista	2,297,254	12,310,000
	Total	\$3,671,605	\$21,650,000

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR COMMENTS NOT YET IMPLEMENTED

2006-05 Assessment District Debt (Continued)

Our experience is that special assessment districts may be over-looked in allocating capital, maintenance and administration expenses incurred by a City, even though these expenses are incurred on behalf of these districts. We did not see any such charges by the City to any of these Districts. The City should determine whether it has properly charged its assessment districts for these costs, if allowed by the respective Debt Indentures. The City should also complete this review with each District's bond counsel to determine the restrictions on the excess funds.

Current Status:

In process.

OTHER RECOMMENDATIONS

The following recommendations are equally important, but do not arise out of reportable conditions as defined above.

2006-11 Investigate and Clear Old Outstanding Checks

The June 30, 2006 outstanding check listing for the general checking account included \$240 thousand of checks that were outstanding for more than one year in the general checking account, as far back as 1996, including checks totaling \$69 thousand outstanding from the prior general ledger system (PRIME System). The payroll checking account and worker's compensation checking account had checks outstanding for more than a year at June 30, 2006 of \$30 thousand and \$140 thousand, respectively. We made this recommendation in 2005 and provided Finance staff with the information necessary to address stale-dated items, but did not see any improvement. The City should establish a process for periodically reviewing and clearing stale dated checks.

Current Status:

Implemented.

2006-20 Deposits Payable

We selected twenty-five deposits payable balances for testing and noted the following:

- A. Supporting documentation could not be located for one deposit in the amount of \$177,200 related to a Point Molate security deposit received on June 26, 2004.
- B. One deposit in the amount of \$295,200 recorded in the City's General Agency Fund had already been refunded to the developer from the City's General Fund.

City staff should review all outstanding deposits payable to ensure that proper supporting documentation exists and that they are still valid deposits payable. In addition, deposits refunded should be refunded from the proper fund in which they were recorded.

Current Status:

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR COMMENTS NOT YET IMPLEMENTED

Implemented.

2006-21 Operating Transfers

When recording operating transfers in the general ledger, both sides of the entry should be recorded simultaneously, in the same journal entry. While trying to determine the cause of a transfer in the City's Treasurer's Fund, we found that one transfer entry was posted using two different journal entries. One-sided operating transfer entries should not be allowed. This practice hinders both the process of balancing transfers in and out, and the process of investigating the source of general ledger activity. Both sides of an interfund transfer should be recorded simultaneously, even if two employees are involved with preparing the entry and reconciliation. The two employees should coordinate and prepare one journal entry.

In addition, the City appears to record a high volume of interfund transfers and corrections to those transfers. The general ledger report of gross transfer activity (both transfers in and out) contains 779 lines of data. Now that the City has closed and consolidated a number of inactive general ledger funds, which was the cause of a number of those transfers, the volume of transfers in fiscal 2007 should be analyzed to ensure that they are necessary.

Current Status:

Implemented, however see status of comment #2007-34.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR COMMENTS NOT YET IMPLEMENTED

FISCAL YEAR 2005 COMMENTS

REPORTABLE CONDITIONS

Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the City's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Under the Single Audit Act and Government Auditing Standards, Management is required to respond in writing to recommendations arising out of reportable conditions.

2005-01 Start Now to Prepare for the 2006 Year End Close

The City issued its 2005 CAFR in March 2006, an improvement over 2004 but still very late. A reasonable target date for the issuance of the 2006 CAFR is January 31, 2007. This date will allow the City to submit its CAFR for award consideration and represents a significant improvement over 2005. However, to achieve this level of improvement, the Finance Department must start now to plan the 2006 closing of the books. Some of the major tasks that need accomplished include:

2. Since the SAP accounting system now in place must be used throughout 2006, the City's IT Department and Finance Department must work together to improve that system's performance. Our experience is that the SAP system is the least useful of any accounting system we have seen. It does not appear to provide many of the most basic municipal accounting reports. Finance personnel do not understand or trust the SAP system, so they do not use it any more than necessary. Worse than that, relations between Finance and IT personnel have deteriorated to the point that there is little effective support provided by IT to Finance. Nevertheless, the SAP system is likely to be in place during the 2006 close, and must be made as effective as possible.
5. Finance should begin now to strengthen the monthly reconciliation and analyses of accounts so that errors can be discovered and corrected on a timely basis and the work required to close the books reduced accordingly.

Current Status:

2. Implemented
5. Ongoing

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR COMMENTS NOT YET IMPLEMENTED

2005-03 Strengthen Accounting Controls at the Port

The Port owed the City \$1.5 million dollars at June 30, 2005 despite having actually turned a profit for the first time in some years. Close examination reveals that the 2005 profit is not necessarily a harbinger of more profits to come. An operation as risky and complicated as the Port, with much potential for large profits or losses, should be subject to tight accounting controls.

Nevertheless, our audit disclosed that the Port personnel we dealt with were unable to determine how much was owed by each Port customer or how old the receivables were, made no apparent effort to collect over-due receivables, were not aware that payments were being made directly by a lessee to a trustee of a Port debt issue and did not account for these payments, did not know that the Port's reserve for doubtful accounts receivables at June 30, 2005 exceeded the Port's entire accounts receivable balance by over \$500,000 and had not seen the Port's financial statements.

Accounting for transactions with steamship line customers and Port tenants is very different from other City accounting functions. That, coupled with the physical isolation of the Port's operations, means that while risks are higher at the Port, accounting, supervision and control have all been lacking. At present, the accounting function is being handled by someone whose title indicates he is not an accountant.

The Port needs its own on-site accountant. That accountant should be provided specific, detailed training in the specialized nature of Port and steamship accounting and should report directly to the Accounting Manager.

A set of standard monthly reports should also be developed for presentation to the Port Director, the Accounting Manager and Finance Director at least monthly.

Current Status:

In Process

2005-04 Collect Over-due Accounts Receivable

The gross balance of accounts receivable at June 30, 2005 was \$21 million, of which \$1.1 million was owed the Port and \$6 million was overdue by 90 days or more. We understand that no employee is responsible for pursuing delinquent accounts. An experienced collections person should be assigned to this task immediately. If there is no such person on staff, one should be hired; the cash they produce will cover their cost several times over.

This collection problem has not been more apparent in the past because the City sets a bad debt allowance of 100% of amounts due over 121 days, and 85% of amounts due over 91 days. At June 30, 2005, the allowance for bad debts totaled \$2.7 million, nearly 50% of the total overdue by 90 days or more. An experienced collections person should be successful in collecting many of these accounts.

Current Status:

In process.

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR COMMENTS NOT YET IMPLEMENTED

2005-11 Reconcile Employee Receivables and Collect Amounts Due

The City's records indicate that seventy-six employees, including forty-one former employees and at least two who are deceased, owed the City a net amount of \$63 thousand at June 30, 2005. The gross amount owed totaled approximately \$81 thousand, while there were \$18 thousand in credit balances.

The worksheets used to track these balances and the reasons for the balance include both positive and negative amounts. Amounts due to the employees (negatives) should be resolved timely to ensure they are not errors, since some of these negative balances indicate they are payments from the employee, but there was no offsetting receivable in the spreadsheet. In addition, the worksheet should be reviewed to ensure it includes all amounts due from employees, since we noted that one exception from our interim payroll testing that resulted in an employee receivable is not included on the spreadsheet.

Current Status:

In process.

2005-12 Monitor Activity in the Sewer and Marina Funds

While the City has outsourced the maintenance and operation of the sewer system facilities and the marina operations, transactions in the Sewer Enterprise Fund and Marina Enterprise Fund should still be analyzed to ensure that the third-party operator is accurately billing the City and applicable charges are capitalized or expensed.

During the fiscal 2005 audit, we asked questions regarding fluctuations from 2003, 2004 and 2005 in both Funds and found that no one could readily respond to our questions. We received some responses, but upon further questioning, the responses changed. After some further research, Finance staff were able to answer the questions, but as a result they found that additional capital assets costing \$2.8 million needed to be capitalized and reversed from expense in the Sewer Enterprise Fund. Errors such as these could eventually have an impact on rates.

Current Status:

Not implemented. See comment number 2007-04

**CITY OF RICHMOND
MEMORANDUM ON INTERNAL CONTROL**

STATUS OF PRIOR YEAR COMMENTS NOT YET IMPLEMENTED

OTHER RECOMMENDATIONS

The following recommendations are equally important, but do not arise out of reportable conditions as defined above.

2005-15 Clarify Job Descriptions and Responsibilities

Current Status:
In Process.

2005-22 Close the General Debt Service Fund

Current Status:
Implemented.

2005-24 Increase Storm Sewer Rates or Reduce Costs

Current Status:
In Process.

2005-28 Review Internal Service Fund Charges for Adequacy

Current Status:
In process.

2005-30 Consider Alternative Funding for Pension Plans

Current Status:
In process.

2005-32 Implement Positive Pay for Worker's Compensation and General Liability Accounts

Current Status:
In process.

2005-33 Investigate and Clear Old Outstanding Checks

Current Status:
Implemented.

2005-36 Prepare for the Financial Effect of Recording Other Post Employment Benefits (OPEB)

Current Status:
Implemented.

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CITY OF RICHMOND

REQUIRED COMMUNICATIONS

December 22, 2008

To the City Council of
the City of Richmond, California

We have audited the financial statements of the City of Richmond as of and for the year ended June 30, 2008 and have issued our report thereon dated December 22, 2008. Professional standards require that we advise you of the following matters relating to our audit.

Financial Statement Audit Assurance: Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit in accordance with generally accepted auditing standards does not provide absolute assurance about, or guarantee the accuracy of, the financial statements. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is an inherent risk that material errors, fraud, or illegal acts may exist and not be detected by us.

Other Information Included with the Audited Financial Statements: Pursuant to professional standards, our responsibility as auditors for other information in documents containing the City's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. Our responsibility also includes communicating to you any information that we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements. This other information and the extent of our procedures is explained in our audit report.

Accounting Policies: Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the City is included in Note I to the financial statements. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2008. As described in notes to the financial statements, during the year, the City implemented the following new standards:

GASB Statement No. 45 - Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions

GASB 45 uses Pension Accounting (GASB 27) to change the accounting for Other Post Employment Benefits (OPEB) to full accrual at the Entity-wide and proprietary funds financial statement levels. Under the concepts in GASB 45 an actuarial study or simplified measurement method calculation is performed to determine an Annual Required Contribution (ARC). So long as employers contribute this amount every year, no accrual adjustment is needed in the financial statements. A summary of the impacts of this statement are presented below.

REQUIRED COMMUNICATIONS

As discussed in Note 12 to the financial statements, during the year ended June 30, 2008, the City contributed the ARC for fiscal 2007-08 by paying retiree health care premiums and additional contributions to into a separate irrevocable trust established for the sole purpose of funding OPEB. This Trust is governed by a separate board, which is not appointed or controlled by the City Council or management and it has therefore been excluded from the City's financial statements.

There was no cumulative effect of the accounting change as of the beginning of the year.

GASB Statement No. 48 - Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues

This Statement establishes financial reporting of several categories of transactions. There was no cumulative effect on prior year financial statements. However, Note 7 to the financial statements was modified to include disclosures of revenue pledged for repayment of debt.

Unusual Transactions, Controversial or Emerging Areas: No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2008.

While there have been no changes in accounting policies or disclosures resulting from the credit crisis, we believe the unprecedented volatility of credit markets occurring after year end warrants mention.

Credit Risk and the Financial Crisis: The City has credit risks in two areas of its operations: investments (Note 3) and long term debt, especially its swap agreement (Note 7). Credit risks as of June 30, 2008 for these areas have been disclosed in accordance with generally accepted accounting principals.

However, subsequent to year end, financial markets experienced significant reductions of available credit and certain financial institutions have had their credit ratings downgraded with one large institution entering bankruptcy. The federal government has taken steps to support financial markets in an effort to stave off further negative trends. These conditions have increased credit risks which warrant continuous monitoring and reassessment of the risk that credit counterparties and investees maybe downgraded or be unable to fulfill their obligations. The City should place the highest priority on maintaining a credit watch on its counterparties and formulate contingency plans as needed to ensure credit remains available for its operations.

Estimates: Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. The most sensitive accounting estimates affecting the financial statements are the fair value of investments, depreciation, fair value of swaps, compensated absences, and claims liabilities as noted below:

REQUIRED COMMUNICATIONS

Estimated Fair Value of Investments: As of June 30, 2008, the City held approximately \$328.9 million of cash and investments as measured by fair value as disclosed in Note 3 to the Financial Statements. Fair value is essentially market pricing in effect as of June 30, 2008. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2008.

Estimate of Depreciation: Management's estimate of the depreciation is based on useful lives determined by management. These lives have been determined by management based on the expected useful life of assets as disclosed in Note 6 to the financial statements. We evaluated the key factors and assumptions used to develop the depreciation estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Estimated Fair Value of Swaps: The City has five Swap arrangements with negative fair values in favor of the respective counterparties totaling \$10.1 million, as disclosed in Note 7 to the financial statements. Fair value is essentially market pricing in effect as of June 30, 2008. The fair value is not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2008.

Estimate of Compensated Absences: Accrued compensated absences which are comprised of accrued vacation, holiday, and certain other compensating time is estimated using accumulated unpaid leave hours and hourly pay rates in effect at the end of the fiscal year as disclosed in Note 2 to the financial statements. We evaluated the key factors and assumptions used to develop the accrued compensated absences and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Estimated Claims Liabilities: Management's estimate of the claims liabilities payable is disclosed in Note 14 to the financial statements and is based on actuarial study determined by a consultant, which is based on the claims experience of the City. We evaluated the key factors and assumptions used to develop the estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Disagreements with Management: For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the City's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Retention Issues: We did not discuss any major issues with management regarding the application of accounting principles and auditing standards that resulted in a condition to our retention as the City's auditors.

Difficulties: We encountered no serious difficulties in dealing with management relating to the performance of the audit.

REQUIRED COMMUNICATIONS

Audit Adjustments: For purposes of this communication, professional standards define an audit adjustment, whether or not recorded by the City, as a proposed correction of the financial statements that, in our judgment, may not have been detected except through the audit procedures performed. These adjustments may include those proposed by us but not recorded by the City that could potentially cause future financial statements to be materially misstated, even though we have concluded that the adjustments are not material to the current financial statements.

We did propose audit adjustments that, in our judgment, could have a significant effect, either individually or in the aggregate, on the City's financial reporting process related to recording of the City's budget data, long term debt activity, revenue accruals, and loans receivable and that are described in items 2008-01, 2008-02, 2008-04, and 2008-10, respectively, of the Memorandum on Internal Control.

Uncorrected Misstatements: Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We have no such misstatements to report to the Council.

This report is intended solely for the information and use of the audit committee, City Council, and management and is not intended to be and should not be used by anyone other than these specified parties.

Maye & Associates